Five Key Success Factors for Subscription Vendors

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For companies adopting a subscription business model, it all boils down to customer data — how you collect and use it. When migrating from conventional business models mediated by ERP, it's best to start by understanding the data you generate and then use it effectively.

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Overview

Business models change with the economy and with them so does the data that determines the success of a business. The United States is no longer an agrarian economy and farming is the business of only three percent of the population today. So very few companies organize their businesses based on crop prices and weather patterns.

Similarly, the U.S. is no longer a manufacturing economy either as nearly seventy percent of the GDP is in services. Yet many companies still organize themselves along manufacturing business models governed by ERP systems — enterprise resource planning. Unfortunately, these systems are growing apart from the business practices they were meant to serve because they fail to place the customer in the center of the business and because they don't provide the flexibility to manage subscriptions.

As services have shifted to subscriptions and recurring revenue models, many companies have found that conventional ERP fails them. In order to reconcile subscription business models with conventional systems, businesses are finding that they have to use spreadsheets and other data management approaches that run outside of the ERP system. In short, they have a data problem.

In a conventional product centric business, the business model, and the business management system, are built around an understanding of the core product, the material thing being delivered. But a subscription company orients around the whole product, which can easily include the core product as well as its quality, price, availability, delivery, and terms making them all part and parcel of the deliverable. So a subscription management system has more work to do on behalf of the vendor and the customer.

So, at the center of a subscription business is the vendor-customer relationship, and subscription businesses naturally need data and metrics that are related to the health of this relationship.

ERP systems don't recognize what a modern customer is; they have no ability to predict whether this customer will be back next billing cycle or if the current purchase is a one-time occurrence. So subscription vendors have to leverage customer subscription data to see into the needs and aspirations that are critical to their subscription business.

In this Beagle Research executive white paper, we examine five critical success factors that most subscription companies face and they all boil down to customer data — how much of it a company can gather and how they analyze it to exploit the information it contains. Together, these success factors forecast how subscription companies succeed or fail.

Five Success Factors

1. Building and Maintaining Customer Relationships

The biggest challenge confronting businesses hoping to make a transition to a subscription model is the new focus on the customer relationship. In the subscription economy, the customer relationship is the lifeblood of a company, and therefore nurturing and retaining that relationship is a task that requires a great deal of attention.

Subscription businesses are different from their conventional product-oriented cousins beyond the delivery method. A conventional company has an arms length relationship with its customers. Sales creates a relationship between a vendor representative and a buyer that often dissolves after the deal.

In contrast, subscription companies integrate aspects of marketing, sales and service into a single point of contact and the relationship can be modified with each billing cycle.

Subscriptions are more intimate. Customers interact with all aspects of a subscription vendor's organization without regard for the internal boundaries between say, sales and service. In fact service looks a lot like sales in many subscription companies because it becomes the more dominant point of interaction. Most importantly, intimate subscription relationships have three key attributes in common:

1. **Much faster turns.** Customers change the subscription configuration at will to adjust consumption to their immediate needs and knowing that they can reverse the changes just as fast.
2. **Lower margins.** In a subscription customers buy just what they need for the immediate future so transactions are much smaller and they generate much smaller margins.
3. **Ability to walk away from a relationship with little notice.** The subscription model is designed to provide maximum flexibility so that if the relationship sours for any reason, the customer is free to disengage.

Fortunately for the vendor, subscriptions generate a great deal of data that vendors can analyze and this analysis produces the knowledge needed to address the intimacy needs of the subscription relationship. With knowledge derived from customer uptake and use data, a vendor can easily see if a customer is aggressively using a solution, struggling with a product or giving up.

Customer retention, churn and renewals are all metrics derived from customer data. Other metrics related to use and frequency — number of users over all, number per unit time and products used per customer — can tell a vendor well in advance if a relationship is at risk because the customer is not receiving maximum value. Armed with such information that the subscription vendor can take corrective action when needed.

2. Re-aligning Your Business Systems to Support Subscriptions

Transitioning from making and selling things, as a conventional company, to making things and selling subscriptions is a big deal. Subscription management requires constant information about demand, customer acceptance and any drift in satisfaction that could later be reflected in a smaller purchase. So when a business re-orients to subscriptions one of the key adjustments is in collecting data about repeatable processes that might be one time events in a conventional company. For instance demand and consumption rates become critical to understanding a subscription business and provide key insights to customer satisfaction.

Most of the change happens in business practices and the supporting software systems rather than in the core products because subscriptions offer more points of contact between vendors and customers and the relationship is more intimate. Customers see vendors more as partners and rely on them more for their success. Some of the most important areas of differentiation between a product company and a subscription company — which goes to the heart of intimacy — include:

1. **Configuring deliverables.** A customer subscribing to a "wine of the month club," for instance, might buy many cases of wine over time but that customer won't want to take delivery — or pay for — all of them at once. So a subscription vendor needs to scale the deliverables to reflect the demand and consumption rates. Monitoring these and other rates provides key data for managing a subscription company's health.
2. **Operational efficiency.** At the same time, the vendor has to become even more operationally proficient to ensure that the right product is delivered at the right time and that the accounting is correct too because the small margins on each transaction can be quickly used up in any rework. Finally, subscriptions offer greater chance to vary the deliverable opening up new product configuration opportunities that could swamp a conventional ERP system, so subscription management systems have to be able to support higher transaction volumes and custom configurations.
3. **Terms and conditions.** The "T's and C's" of subscriptions are tightly inter-wound with the actual service delivery. The subscription term might be a month but it will also automatically renew and be potentially subject to editing and cancellation. The term might cover multiple subscription periods such as when a monthly subscription is paid a year in advance and business systems need a way to account for monies collected but not applied to an agreement. These monies present another data opportunity and a way to analyze the health of the business. For example, deferred revenues should always grow in a company that is adding new customers and signing them to long term agreements or in a company that is increasing its footprint in its customer base. Where deferred revenue is not growing, it could signal low success with renewals.

4. **Sales and service.** The difference between sales and service shrinks considerably for a subscription company. Once passed the initial purchase, which may happen through an automated Web interface, customers may interact with service agents or through the same Web interface. Either way, changing a configuration, adding capacity and products or changing the order are all sales interactions with a significant service element and they have to be executed correctly and with efficiency.

In all of these circumstances, the ERP systems that support a conventional business will be a poor fit for the subscription business model. Once you internalize the ways that subscriptions change the vendor-customer relationship, and the way a company organizes itself to deliver subscriptions, you can turn your attention to the three remaining challenges any company faces — Growth, Business Flow and gaining maximum Knowledge about the business.

3. Growth

In a conventional business, you grow through developing and selling more products. While in a subscription business, you grow by adding more customers and then further monetizing those customers.

The major success factor for subscription businesses is identifying and then securing the most profitable customers. With all the data that a subscription company generates, it's often possible to identify which customers are most profitable, which require a lower ratio of onboarding and other services and which customers are poised for growth.

These activities are based on information that can be gathered by analyzing customer-generated data for three important sets of parameters. Using subscription data, a company can be more profitable and faster growing. Here's how:

1. **Uptake and use.** Simple use statistics from your subscription management system can tell you over time if customer use is increasing or whether uptake varies by season. Regardless, armed with this data you can develop key performance indicators (KPIs) for your business that track uptake and show use tolerance ranges. This information is critical to understanding when an account might be in jeopardy.
2. **Churn and annual renewals.** Churn can refer to losses on a short-term basis while contracts renew on a longer term basis. In either case, a company grows most easily when customer retention is high. A subscription company is more profitable when established customers stay put because they will not usually require onboarding activities that cut into margins. So measuring churn and renewals can help pinpoint whether a company is growing but they are also indicators of how profitable a subscription company is.
3. **Recurring and deferred revenue.** Finally, a growing subscription company will, over time, generate increasing amounts of recurring

revenue as the customer base grows. If the subscription company also engages in long-term contracts where the revenue is recognized in small (monthly) increments, then the company will have an increasing amount of deferred revenue on its books, which is another measure of growth.

4. Business Flow Optimization

You may be tempted to think of business flow as something you already have covered with a conventional ERP system but you should think again. The processes that you need to optimize your business are different in a subscription business. And conventional ERP systems that aren't built to handle recurring revenue have no concept of a repeat customer so they can't handle the complexity of subscriptions.

Once you've done everything you can to set up your business for growth by identifying the best customer types and identifying the most profitable products, strategies and niches, you still have to execute.

Subscription businesses generate more data for a finance team to understand and leverage. Most companies discover there is an almost infinite variety of deliverables made possible by the subscription model because it enables recombination of individual products in innovative ways. Now, imagine administering this huge array of deliverables against an equally large array of customers with differing needs and you can quickly realize a screaming need for automation. That's both the challenge of optimization and the reason why your ERP system isn't up to snuff.

Customers expect seamless flow from order to fulfillment and they expect any changes to be reflected accurately in their statements. Vendors strive for this flow because it results in few errors, less rework and higher margins. When vendors elect to use conventional ERP in subscription businesses they inevitably resort to spreadsheets to handle data and operations that have no analog in ERP. But much of the customer data we've discussed so far will be less accessible because it will be lost in multiple big data clouds.

To avoid these problems the subscription management system has to be part of a larger grouping that encompasses CRM, the general ledger, your website, payment gateways and provisioning systems. When all these systems work together customers have great experiences because they are at the center of everything and you, the vendor, have an integrated, end-to-end set of process flows that minimize costs, maximize revenue and optimize essential customer data generation that the business is built on.

5. Know Your Business

In a conventional business you might look at closed deals, revenue, returns and a variety of measures that are backward looking. That's like steering a ship by looking at its wake.

With a subscription business, you not only have more data at your disposal, but the ability to act on it much quicker. In any subscription business, you can see whether customer retention is increasing or not, what's your most effective discount strategy, and where you're leaving money on the table. The information produced in a subscription business — and its timely application — can easily be the difference between success and failure.

Note

Throughout this paper we've stressed the use of data and metrics to help you understand what's happening in your subscription business and how to optimize it. We've written a separate white paper just on subscription metrics that you can access at http://bit.ly/12dSAuf .

The fundamental point is that managing a subscription business isn't harder than managing a conventional business but that the things you look at and the data you collect and analyze are different.

Your subscription management system should function like a business manager's cockpit, providing you with the metrics-based information you need to proactively manage your business throughout all process flows.

Summary

Subscription business is taking hold for a variety of reasons. Subscriptions turn big acquisitions into small purchases reducing costs and making many products affordable to more customers, which should be good for customers and vendors alike. But compared to conventional business, subscriptions are a high-wire act for the vendor. They require a different set of skills rooted in fast, accurate actions and fact based decisions.

There has been a great deal of focus on billing and accounting issues that subscription businesses face. While this focus is justified this paper demonstrates that companies that exclusively focus on counting the money rather than emphasizing the customer relationship can run the risk of failing to attract and keep their most vital asset, the customer.

We continue to recommend that all our clients carefully examine all facets of their subscription businesses with an eye to analyzing customer-generated data to extract information that will drive future success.

About Beagle Research Group, LLC

Beagle was founded by Denis Pombriant, who has been researching and writing about front office technology since 2000. Our research and analysis is available on many technology venues as well as at BeagleResearch.com. For inquiries or to arrange speaking or consulting reach us at,

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