

Challenges and opportunities in subscription commerce

Recurring payments in the digital age
are a blessing not a curse



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01 Introduction

Consumer behavior has changed in recent years as a result of technological development. Instead of regularly buying the same products, customers are increasingly relying on chargeable on-demand solutions. This is not only the case for physical products but for services, too. Logical conclusion: Retailers need to adapt to the needs of consumers in order to develop sustainable customer relationships. Here, new business models such as subscription-based are of increasing interest for online transactions, too.

The creation of so-called subscription commerce offers benefits both – for customers and retailers. Consumers automatically receive deliveries of products for daily use without having to actively

do anything. This improves the customer journey and leads to higher loyalty, which in turn benefits the retailer. Customer satisfaction leads to customer loyalty – businesses should never forget this causal association. They can build a stronger relationship with their customers via additional touchpoints that subscription models create beyond checkout.

Although payment is only part of the customer journey, it is the most important step towards a sustainable customer relationship. Companies whose products or services generate recurring payments may face special challenges. However, subscription commerce offers many opportunities for significantly increasing their revenues.



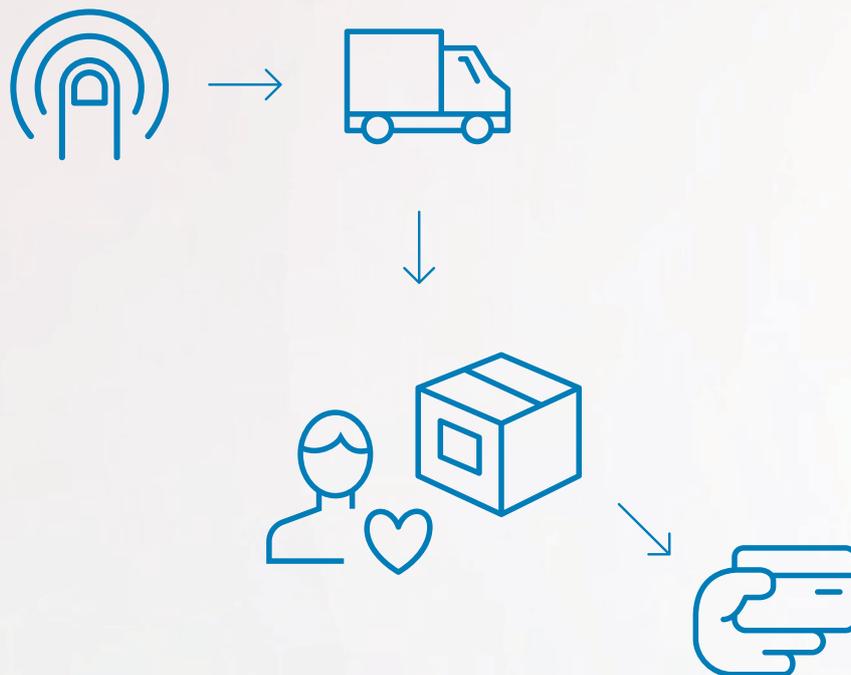
02 Subscription commerce in the digital age

The concept of subscriptions is not new. Whereas in the past the business model was restricted to newspapers and magazines, nowadays there are virtually no product segments that do not involve recurring payments. This includes streaming services such as Netflix, recipe box subscriptions and even airlines. The US conglomerate United Airlines offers its frequent fliers a subscription service that guarantees simpler luggage check-in and seats with more leg room – a package that provides convenience and comfort even before take-off.

The trend towards making the customer as comfortable as possible has also not passed the B2B world by. This is demonstrated by services that are easily accessible through a subscription. One example is SaaS (software as a service) solutions that do

away with the need for expensive licenses. The customer pays for the software only when it is used, requiring only a computer with an internet connection and a web browser to access the service. It's hardly surprising that companies such as Microsoft and Apple moved to subscription models some time ago.

For a long time, subscription-model products were based on fixed intervals stipulated in advance. However, the major players have now developed flexible solutions. Customers can now automatically reorder their favorite products depending on need or consumption. The online giant Amazon is once again playing a pioneering role with its Wi-Fi enabled Dash Button that allows customers to literally order a product at the touch of a button.



02.1 Examining the product: convenience vs. curation

Razor blades, socks, care products, cereal, drinks, pet food – the list of products available via online subscriptions is long. One might assume that subscription commerce is only suitable for low-interest, regularly consumed products, but this is not the case. Subscriptions are being deployed in other industries to target customers' emotions, while technological developments (e.g. cloud and streaming services) and the increasing operational excellence of the logistics industry have created the requirements for successful subscription models.

Equivalent goods used daily or frequently are in demand, mainly due to the service effect (convenience). A product or service is consumed or required at recurring, routine intervals. A subscription saves customers time while also often allowing

them to enjoy the price advantages of purchasing online.

The reasons for premium consumption (curation) are emotional. Successful retailers draw people in with premium goods that are only available on subscription. The customer experience lies in the special selection and the surprise. For example, Starbucks offers selected coffee roasts that cannot be purchased in stores, thereby creating an exclusivity that makes the product subscription interesting. Another lever for making subscriptions emotional is memberships. Because relationships to exclusive customers require different strategies and possibly therefore more complex system requirements, retailers should consider in advance whether this element of the customer journey is actually profitable.



02.2 Examining the model: subscription vs. soft-subscription

Development shows that the conventional subscription model is no longer attractive and is almost impossible to implement in today's market. Customers no longer want to be bound to minimum terms or termination periods but rather want to decide for themselves when and for how long they use a product or service. So-called soft-subscription models are therefore more popular because they are more modern and offer customers the desired flexibility for delivery intervals, termination periods and terms. These dynamic models differ for each industry and end consumer.

For flat-rate subscriptions, as offered for example by such streaming services as Netflix and Spotify, the customer obtains unlimited access to a service for a fixed monthly or annual charge. In contrast, pay as you go models allow customers to only pay for what they actually use. Freemium subscriptions follow a different approach that has proven to be particularly successful online. A basic version of a product is available free and suppliers only earn money when a customer chooses a premium tariff version.

03 **Benefits to customers:** convenience and flexibility

The development of subscription commerce is extremely practical for customers: They automatically receive deliveries of products for daily use without having to actively do anything. This makes daily life simpler and can even allow consumers to benefit from lower prices. Suppliers such as Amazon give their customers a kind of returning customer discount that removes the need to spend time looking for special offers and coupon discounts. Such time saving is a central consumer demand. They want to order, receive and pay for products as conveniently as possible.

This desired convenience is achieved through automation. A feature that not only impacts

the ordering process, but the payment process, too. Once a customer has chosen a payment method, they generally do not need to do anything other than choose the products and receive the goods. Experience shows that customers value the time saved more than recommendations for related products usually promoted by most retailers.

Soft-subscription models provide customers with equal freedom to decide whether to take advantage of an or to terminate or pause a subscription because of a vacation or a current lack of need. Flexibility is the key word – and this is met by the individual subscription options and which offers consumers significant advantages.



Benefits to customers:

Saves money

Saves time

Automated/planned payments

Flexibility and management options

Supplier recommendation marketing

04 **Benefits to retailers:** Plannable revenues and stronger customer loyalty

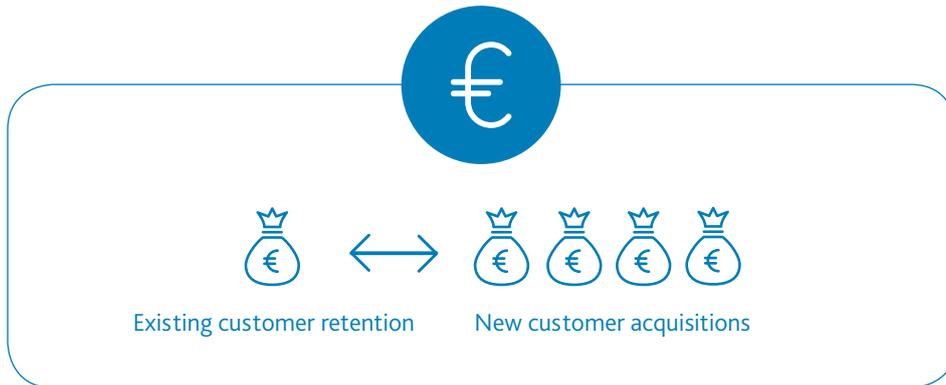
Flexible subscription models are no less attractive for retailers. The higher customer satisfaction leads to stronger consumer loyalty. An advantage of lasting customer relationships is secure revenues that enable long-term financial planning. Recurring payments are accompanied by calculable

incoming payment flows. So, in addition to inventory planning, it is also possible to optimize cash and liquidity management.

At first glance, it may seem as if the business advantages are the main reason for entering subscription commerce. However, of equal, if

04 not even greater, significance is the stronger customer loyalty that can be developed. A subscription guarantees regular contact with the consumer, allowing the relationship between the brand or company and the customer to strengthen over time. The cost of customer acquisition is four times greater

than retaining an existing customer. This is a fact that companies should keep in mind when considering whether to become active in subscription commerce. Another advantage is the data that retailers generate through this special relationship with their customers. If companies create



the right requirements they gain a much more detailed understanding of their customer than is the case for classical retail or e-commerce. This not only refers to the usual data, such as name, age, gender, address etc., but also insights into the consumer behavior and preferences that can consequently be addressed in a much more targeted manner. Retailers who link such data to their digital marketing and sales analyses can increase revenues.

The fact that better customer relationships are always founded on business advantages is also demonstrated by the up-selling

and cross-selling options that additional touchpoints offer retailers. An example: A company that regularly delivers a customer toothpaste can occasionally remind the customer to replace his or her toothbrush or even additionally suggest the use of dental floss.

Digital subscription models not only enable new business concepts, they are also fundamentally suited to supplementing existing business models. Customer acquisition costs may be more expensive than in conventional retail, but they can be spread over the term of the subscription.



05 Challenges for retailers: Market situation and product vitality

Although e-commerce subscriptions are experiencing a real boom, retailers should not blindly jump on the bandwagon but rather be aware of the challenges. A market analysis is essential before deciding to launch a subscription model. If the product is aimed at a target group with a limited-term interest, purchase will be an ongoing issue. Retailers are practically forced to develop new customer groups. This shortens the customer lifetime and consequently the half-life of loyalty offers too.

The loyalty effect or the sustainable vitality of the product is also of key importance. What use is a subscription with flexible or even no termination periods if the customer is not loyal to the product? In contrast to conventional shop and online sales, subscriptions offer many more opportunities to initiate and strengthen loyalty through

the regular touchpoints that provide direct contact with the customer.

When entering a market, the economic challenges must, above all, be considered. Sales through instalment plans initially mean a combination of low revenues combined with high marketing and acquisition costs. Companies who exclusively focus on a subscription model and who need to operate in the black within the first few months will find it hard to survive in the marketplace.

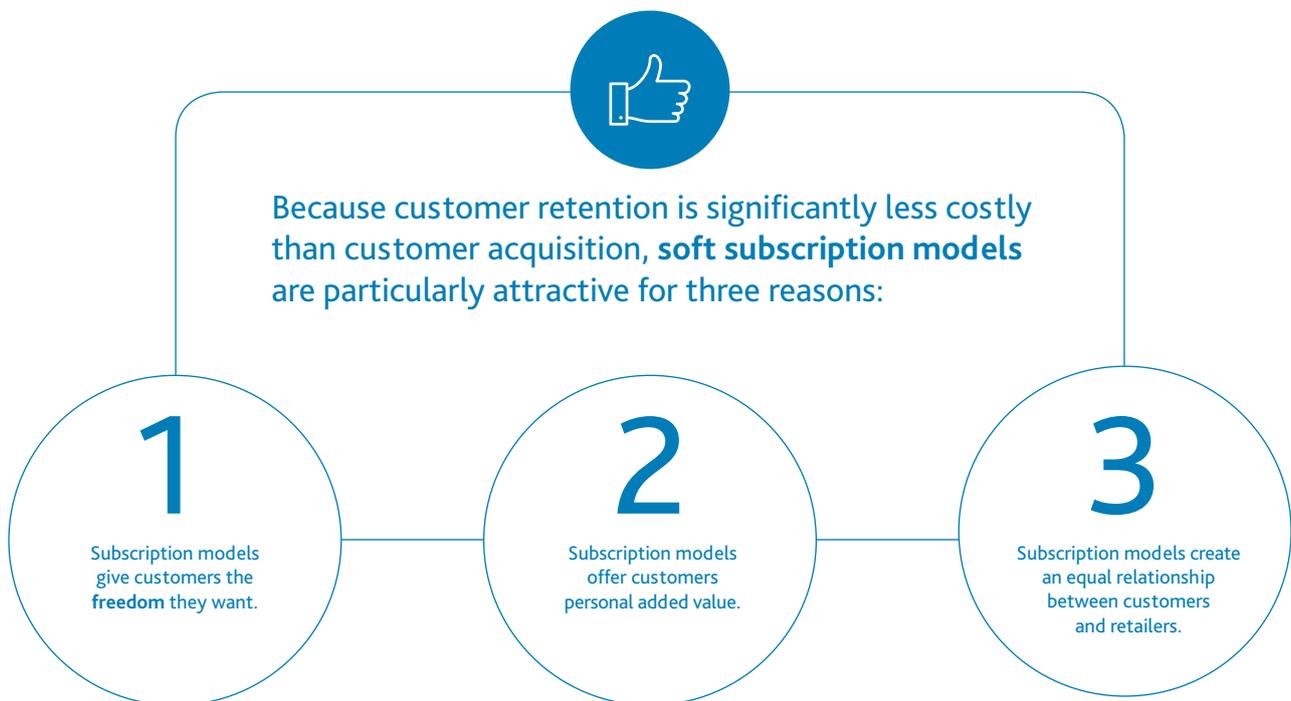
The barriers become even higher if the retailer offers low-priced products with low demand. Due to the much more complex processes involved, and their associated costs, a subscription model will only achieve long-term profitability with sufficiently large customer shopping baskets or order scopes.



06 Opportunities for retailers: Customer focus in subscription commerce

The customer is always right – a motto that generally applies to all retailers, but which has to be practiced in subscription commerce. Subscription models require a service mentality associated with much higher requirements than those in conventional e-commerce. Companies must understand that they are not selling

a finished product but rather a long-term service during which the customer relationship must be continually maintained. On the one hand, this presents the greatest challenge, but it also presents one of the greatest opportunities for companies operating on new business models in the digital age.



06.1 Freedom for the customer: CRM becomes CMR

Consumers have a fundamental need for transparency and flexibility – two aspects that are of key importance in subscription commerce. Customers want to manage their orders and payments themselves. Customer Relationship Management (CRM) therefore becomes a Customer-Managed Relationship (CMR).

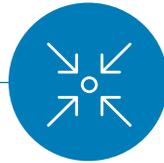
Retailers can create the desired freedom through various elements. A digital customer

account that customers ideally log on to via a social media account creates the necessary transparency. This should provide consumers with an overview of their contract details, costs, and order and contract history. It goes without saying that a well designed account cockpit, email account change notifications, and new offer reminders are key to making the customer journey as pleasant as possible – and are equally important for retailers using a subscription model.

06.1 The second greatest challenge to providing customers with as much flexibility as possible includes several processes. Consumers not only want options when selecting products, they also want to be able to choose how often and when goods are delivered. This results in huge logistical challenges to ensure that product sourcing remains punctual and reliable. A unique sales model may set the conditions for a successful subscription model, but the backend technical requirements are of at least equal importance. If demand is high, retailers should rely on an interface between the shop and inventory management

systems for smoothly managing subscriptions and processing orders.

Another important component of a flexible customer relationship is payment processing and completion. On the one hand, retailers must be able to offer the right selection of payment options (credit card, direct debit, invoicing), while also keeping the challenges of their subscription model in mind. Products sold as subscriptions usually require a dynamic billing structure. This in turn demands enormous flexibility from not only the payment options, but from billing and administration, too.



**Customer-centered focus
is the be-all and end-all**

06.2 Quality and exclusivity create personal added value

Personalization is a keyword that retailers should always keep in mind for subscription commerce. Personalized contact, offers and recommendations may have been used in e-commerce to strengthen customer relationships for a long time already, but consumers attach additional requirements to subscriptions. After all, they expect advantages over conventional shop and online retail purchases. From high-quality packaging designs to customer appreciation communication to the creation of

experiences, customers concluding a subscription demand personal added value.

The exclusive brand personality that consumers are continually updated on, lives from its dynamic. Both the product and service must be continually developed for customers to have the feeling that the retailer is completely in tune with what they need. The focus is not on the brand, product or service but rather on the consumer.

06.2 In the best case scenario, such perceived personal added value moves customers to share their subscription experiences on social networks. Consumers are not only advocates of the brand or company, they actually slip into the role of ambassador. The most effective means of gaining loyalty

and attention are through cleverly choosing hashtags for content on Facebook, Twitter or Instagram, as well as reviews and simple word of mouth. Such earned media effects lead to higher brand awareness, catch the attention of potential customers and, ideally, increase revenues.

One of the most important components of e-commerce (and therefore of flexible subscription models, too) is payment processing.

06.3 Fair play as the foundation of an equal relationship

Whereas conventional subscription models have bound customers to minimum subscription and cancellation periods, subscription commerce employs a completely different strategy: retailers develop customer relationships by keeping entry and exit options as simple as possible. Ideally, logging on requires only a few steps without the need for personal details, while registration and termination are possible with a just single click. Hidden costs or exorbitant shipping costs adversely affect customer relationships and are frequently a reason for subscription terminations.

One of the most important components of e-commerce (and therefore of digital subscriptions too) is payment processing. Customers essentially see themselves as equal to retailers and want to be treated as fairly here as in all phases of the customer journey. Fairness means flexibility, which consists of both the right selection of payment options and the option for subsequent payment. A usage fee is invoiced later and itemed in a transparent bill. Bills can be issued at fixed or monthly intervals (fixed billing) or depending on use (metered billing).

07 Payments for subscription commerce: 3 tips for a higher conversion rate

Digital subscription models generate recurring payments. That which presents retailers with a business management advantage also presents them a technical and procedural challenge.

Discovering the right payment method for a market is probably still one of the easier tasks. In contrast, it is more difficult to choose the right payment solution that ensures card details are kept up to date and that fraud is actively prevented.

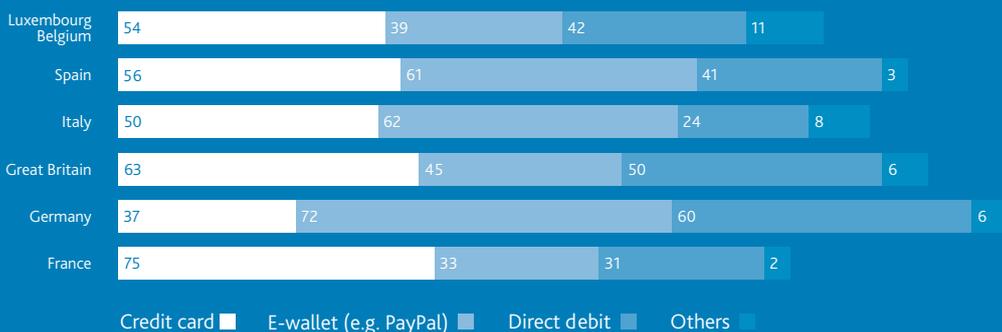


07.1 Tip 1: Identifying relevant payment methods

Consumer payment method preferences vary from country to country. While most EU countries pay online by credit card, German consumers fundamentally prefer paying by invoice or with SEPA direct debit (however, not for recurring payments). 37% of Germans say that they save or would save their credit card details on their phone or online to avoid having to enter them again for their next purchase. More popular are SEPA direct debits (72%) and PayPal (60%).

A global comparison of payment preferences clearly demonstrates the strong differences between markets. It is therefore imperative for businesses wishing to market their subscription models internationally to know the preferred payment methods of different countries.

Which payment method have you saved/would be willing to save online or on a phone to avoid having to enter your details again for your next purchase?



Source: Slimpay



07.2 **Tip 2:** Verify card details early and keep them up to date

Data is the most important revenue driver of the digital age and this is particularly true for subscriptions. For retailers who employ a subscription model, the registration of payment details is not associated with one-off transactions, but with recurring payments that, in the best case, continue over several years. If a customer stores his or her card details during registration, the likelihood increases that he or she will require the product or service for longer in the subscription.

Verifying card details does not, however, prevent failed transactions, which are frequently the key reason why customers leave and revenues are lost. The most frequent reasons for transactions to be rejected are lacking account or cards funds or loss of a credit card. All too often, however, cards simply expire or are stolen and must be reissued. A solution for these problems is available from the respective card's service system. Simply automatically update the details at certain intervals so that customers do not need to actively do anything and are not faced with a purchase decision.



07.3 **Tip 3:** Weigh up fraud prevention against conversion

Customers do not want any risk when paying and expect a secure payment process. That which is true for e-commerce must also be observed by retailers for subscriptions. The problem is that digital subscription models are particularly susceptible to two types of fraud when compared with conventional online shopping: card testing and reseller fraud. Retailers tend to block suspicious transactions too hastily, thereby running the risk of excluding so-called good users from ordering.

Over recent years, efficient solutions have been developed for subscription commerce to identify trustworthy and fraudulent users in real time. Data-supported user and behavior analyses and solutions such as device fingerprinting and relational mapping help to find the right balance between preventing fraud and conversion.

08 Options for billing and administration in subscription commerce

Online retailers generally require a provider so that they can successfully handle recurring payments. The service a company chooses depends on various factors: the product, tariff structure and desired scope of functions. Most subscription models with simple recurring payments are sufficiently served by a payment service provider (PSP), and many online retailers already rely on these.

However, subscriptions with more complex tariff structures require working with recurring billing and full-service providers. Their main advantage over PSPs is that they also manage contract management and settlement: two tasks that are associated with high time and cost requirements – particularly for retailers with a large number of customers or orders.

08.1 Payment service provider

PSPs or simple payment providers are sufficient for handling recurring payments only. The scope of services depends on the provider and generally covers:



- Checking incoming payments
- Renewed debiting of failed payments
- Reimbursement of payments
- Answering customer payment queries
- Risk management and fraud protection
- Protection from lost receivables via a payment guarantee

Working with a PSP has several advantages. On the one hand, all accounts are settled by the service provider. It takes over the customer and handles the debiting or collection of money: from payment reminders to answering customer payment

queries. On the other hand, PSPs usually support several markets so domestic payment processes are used throughout and subscription models can effortlessly operate internationally.

08.2 Recurring billing provider

There are now a range of providers who have programmed a billing and management system for subscription management. In the best case, the automated subscription

handling of such recurring billing providers handles the retailer's complete tariff structure. The service usually includes:



- Tariff changes requested by customers
- Converting credit notes and surcharges during a term
- Factoring and invoice verification
- Creating and sending invoices or reminders by email or post
- Renewed debiting of failed payments

If they cannot process the payment themselves, such providers use one or more payment service providers.

08.3 Full service provider

The services of a full service provider go beyond simple contract billing and management. In addition to calculating incurred taxes and automatically settling

their payment with tax offices (provided by some service providers), retailers can sometimes also take advantage of various marketing options:



- Management of various sales channels
- A reseller function with commission settlement for sales partners
- Connection to affiliate networks
- Email marketing features
- Discount and coupon offers

Because some of these providers have their own payment gateways, working with a PSP becomes unnecessary in such cases.



09 Summary: Practical tips for subscription commerce

1. Product market fit:

Retailers and manufacturers should determine in advance whether a subscription model is suitable for their product. Does the product or service have sufficient loyalty effect and sustainable vitality to create ongoing demand?

2. Business management analysis:

Establishing flexible subscription models is associated with high initial costs. If companies are reliant on immediate profit or quickly generating the highest possible revenues, they should stay away from e-commerce subscriptions. Because subscription models create continued and successful customer relationships, companies can use cross- and up-selling options to achieve higher revenues in the long term than they can with a conventional sales model.

3. Process security:

The requirements that link customers to subscription models are much higher than in conventional retail and e-commerce. The challenge of remaining close to customers and being able to flexibly respond to their individual wishes runs through nearly all of the processes. Companies should therefore create an interface between the shop and inventory management systems for smoothly managing subscriptions, perfectly processing orders, and ensuring on-time distribution.

4. Customer-centered focus:

Because subscription models require a high service mentality, retailers and manufacturers must always align

their product or service to customers' requirements. Transparency and flexibility are two keywords that companies should always keep in mind. In order to continually keep customers excited about a subscription, it is also advisable to use a product's high quality and exclusivity to create emotional added value. In addition, the effort of ordering products for daily use should be kept as low as possible for the customer. Companies must ensure that they satisfy the customer's expectations in all areas and can meet the quality promise for what is basically a permanent service.

5. Conversion rate optimization:

Subscription commerce can only achieve high revenues if the checkout meets the relevant requirements. Once retailers and manufacturers have identified those payment methods relevant for their market, they should integrate fraud protection measures that do not adversely affect conversion rates and which are based on user and behavioral analysis data. The early verification of card details, which can be continually kept up to date by the relevant systems, provides additional conditions for improved conversion rates.

6. Choosing the right payment provider:

Most companies require the help of a provider to handle recurring payments. The right service provider depends on the product, tariff structure and desired scope of functions. Three factors are therefore fundamental when deciding whether a product should be offered as a flexible subscription model.



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