



Succeeding in a squeeze

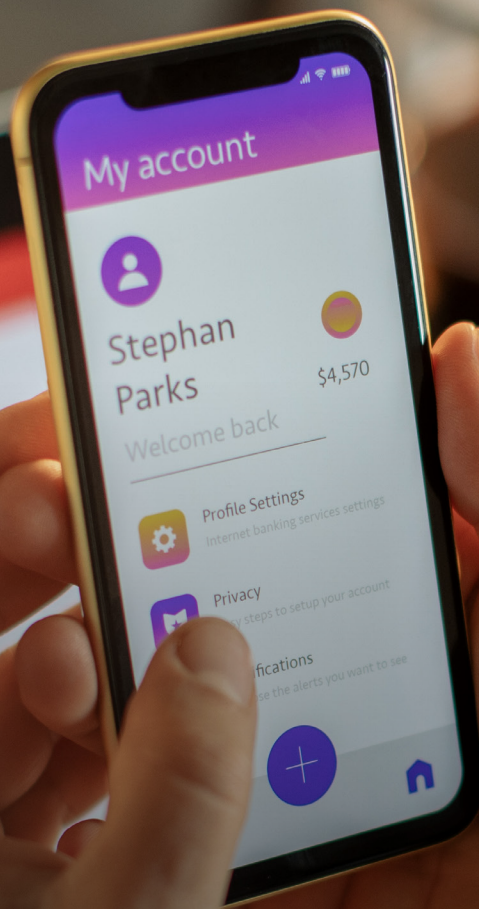
Five ways to flex and futureproof subscriptions



OC&C
Strategy consultants

uncommon sense™

With inflation at its highest rate in over 40 years, and consumers reassessing their spending, businesses are having to work harder – and smarter – for the money in people’s pockets. Here we propose five practical actions businesses can take to stay ahead.



Inflation has run at an average of 7.7% in the US in 2022,¹ weighing on consumer’s purchasing power. However, a wide variety of financial circumstances lie behind this; we expect a “squeezed middle” with weak wage increases, low/expired government support and insufficient Covid savings to bridge the gap.

There’s also uncertainty among economists about how this period will play out. Depending on your economic perspective, we’re either headed into a prolonged economic downturn or this is a short-term bump in the road that will soon lead to new growth.

¹ 12 months up to October 2022 according to the US Bureau of Labor Statistics.

The Bull predicts...

...that, with Covid-19 largely behind us, supply chain issues will ease as new capacity comes online and helps meet pent-up post-Covid demand. They expect there to be a rebalancing in the energy market as domestic production increases, and for central banks to use interest rates as a brake on inflation. With this logic, they expect the many drivers of inflation to subside in the short term.

Our team believes we'll grow this year and next year

Brian Moynihan, CEO Bank of America

The Bear predicts...

...that high inflation will continue as tight labor market conditions push wages up. The prolonged and worsening situation in conjunction with a contentious domestic political environment makes for a long-term slowdown and possible global recession.

We're in another global recession scare now, except this time we think it's for real

Robin Brooks, Chief Economist Institute of International Finance

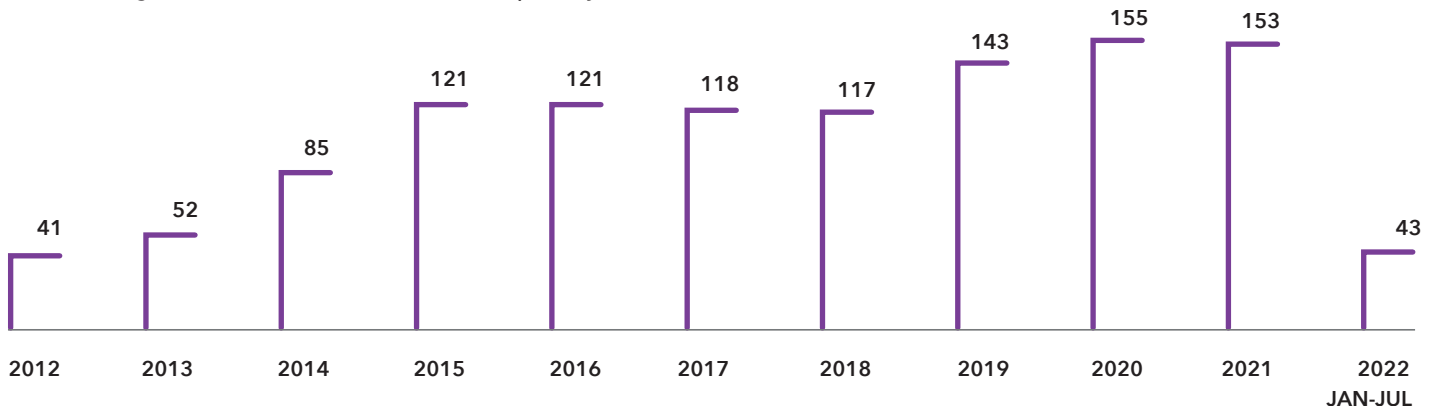


Cancel, pause or change?

Direct-to-consumer subscription businesses have boomed over the last ten years, with over \$10bn of VC investment made in subscription businesses over the last five years across North America and Europe.

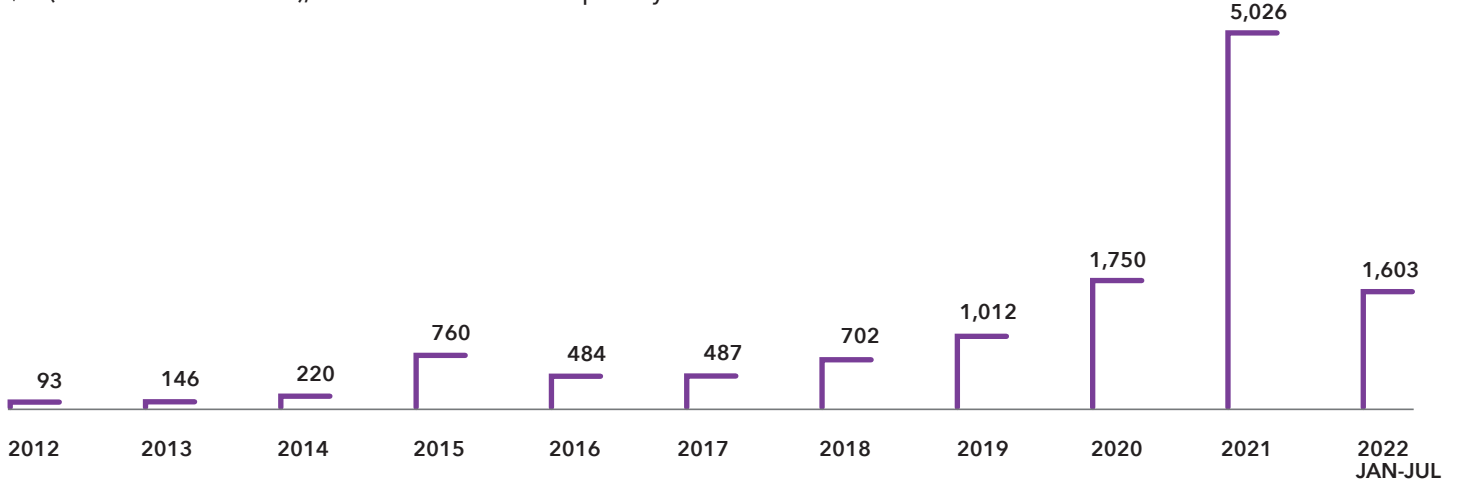
FUNDING ROUNDS FOR SUBSCRIPTIONS BUSINESS BY YEAR OF ANNOUNCEMENT, 2012-2022

of Funding Rounds, North America and Europe only



FUNDING INVESTMENT IN SUBSCRIPTIONS BUSINESS BY YEAR OF ANNOUNCEMENT, 2012-2022

\$m (for known deal values), North America and Europe only



Based on all deals classified by Crunchbase as subscription businesses in North America and Europe
Source: Crunchbase OC&C analysis

The relative youth of the sector means that most of these businesses are facing a high inflation environment - and the challenges of adapting to meet it - for the first time. While subscriber levels at most digital subscription businesses such as Spotify, the New York Times, Match Group, and Bumble have held up well, growth is flattening out.

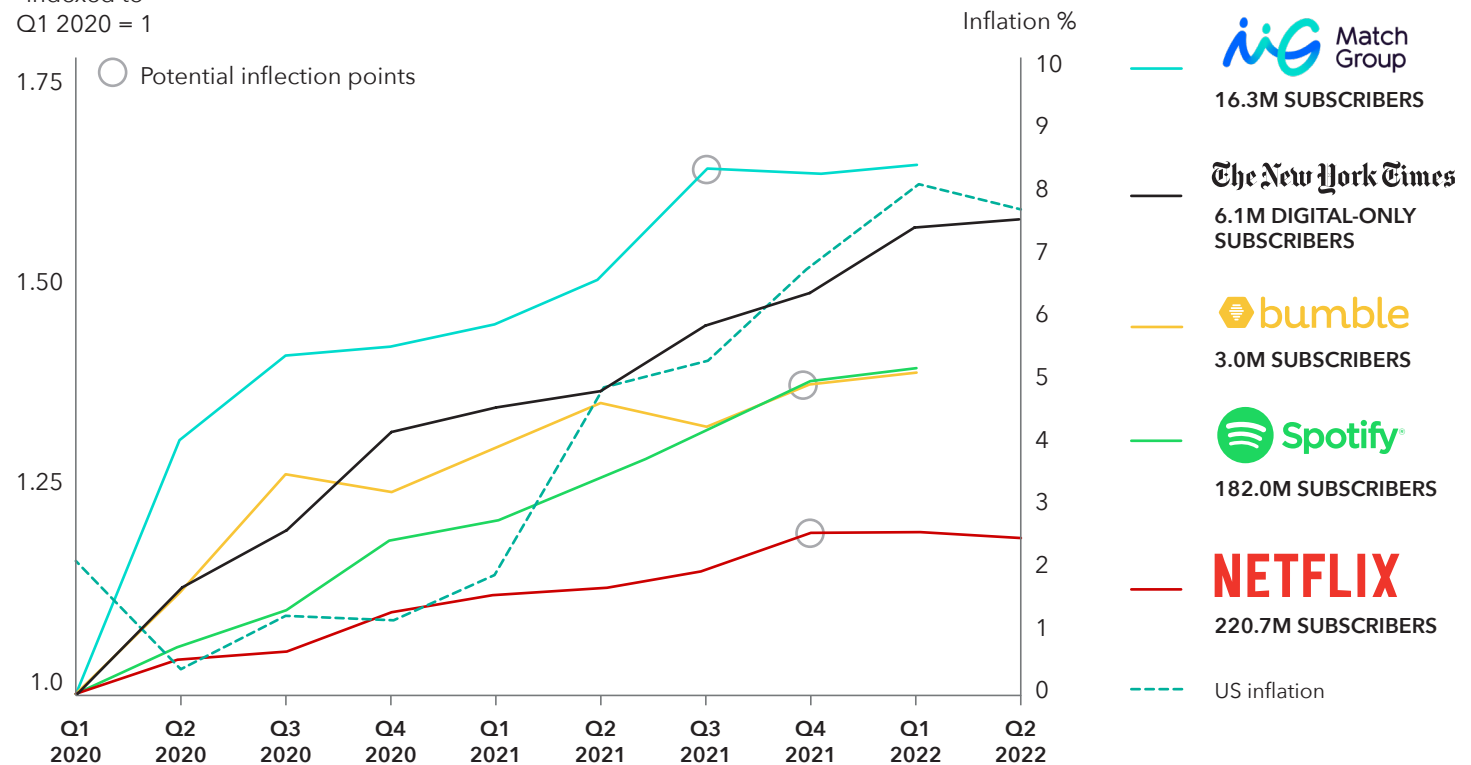
Netflix, with its large and relatively mature subscriber base, recently reported its second straight quarterly drop in subscriber growth and lost one million viewers in the second quarter of 2022. While this drop is small in the context of its 221m subscriber base, it is significant in the context of a historic trend of consistent growth.

Might growth in subscribers be starting to slow in response to high inflation?

NUMBER OF DIGITAL SUBSCRIPTIONS

Selected Players, Q1 2020 - Q2 2022

Subscriptions, indexed to Q1 2020 = 1



Source: Statista, company websites, press releases

The constant reports of high inflation, rising food and energy costs and the consequential squeeze in household incomes is likely to act as a trigger for consumers of all income levels to reassess their spending, including discretionary subscriptions.

To do more than just survive the current economic turbulence, subscription businesses need to act.

Feeling the pinch: the impact of inflation on four kinds of customers

How consumers redress their spending in the face of economic uncertainty depends on their income and attitudes. When it comes to subscriptions, Mary, Dave, Joe and Emily each take a differing approach:

Mary

Annual disposable income... **\$28k** Neutral impact- inflation offset by family support



Although she is a recent graduate with an entry-level salary, as part of Gen Z, described as “subscription generation,” she’s likely to perhaps have more subscriptions than other demographics with more disposable income. She splits bills with her two roommates and doesn’t have a car since she lives in a large city with good public transportation; she is therefore less affected by the spike in energy costs.

Although her salary isn’t keeping pace with inflation, she has asked for help from her parents, which keeps her income pretty much level. That said, given all the negative news, she is looking at how to save without affecting her lifestyle. She might choose to share her subscriptions with friends to lower per person cost. She is considering cancelling some of her streaming subscriptions as well as downgrading to cheaper, ad-supported options.

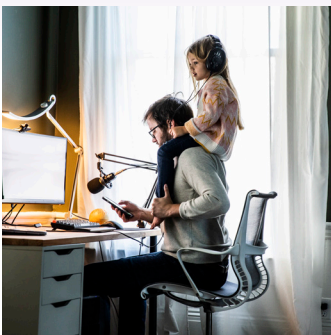
Spend per month...

\$200



Dave

Annual disposable income... **\$55k** Noticeable impact - inflation significantly affecting discretionary spending



With a family to support, a house and two cars, he’s feeling the full impact of food and energy inflation, which is taking up a larger proportion of his income. He’s already cut back his subscriptions spending to the ones he considers essential: Disney Plus for the kids and Netflix as the primary streaming subscription.

He is actively looking to switch to cheaper tiers for his existing subscriptions. He already cancelled his grocery delivery service and purchased a Costco membership. He also switched from Crunch to Planet Fitness and reduced the number of streaming subscriptions to two from four (cancelled HBO Max and Peacock). He is not planning to cut on anymore subscriptions since these are the cheapest entertainment options for the whole family.

Spend per month...

\$40



Emily

Annual disposable income...

\$75k

Impacted - but enough room in discretionary budget not to affect lifestyle



After she retired from her full-time job, she's enjoying her part-time job in the local community college and the extra time to take online classes. She's generally a frugal person, but she's worried about the impact of high inflation on society more broadly, rather than on her personal finances.

She still wants to evaluate unnecessary costs, especially as she's seeing increases in her bills. But she'll need to check in with her children, as they use her logins more than she does!

Spend per month...

\$275

NETFLIX

amazonPrime

HBOmax

Spotify Premium



MasterClass

The New York Times

coursera

hulu

Joe

Annual disposable income...

\$165k

Positively impacted - accumulated Covid savings and salary growth more than offsets inflationary impact



With two professional incomes, household finances have never been an issue and there is plenty of room for luxuries and holidays. Prices do keep going up, but with two years' worth of canceled holidays, he's determined to live life to the fullest and make up for the lost time.

He is a big football fan and has been subscribed to multiple services to have a full coverage of NFL, College Football and local sports. He also has both Equinox and Peloton subscription even though he hasn't had much time to exercise as he is now back to going into the office three days a week.

Spend per month...

\$500

NETFLIX

amazonPrime

hulu

HBOmax

Spotify Premium

EQUINOX

PELOTON

The New York Times

DIRECTV stream

XBOX GAME PASS

The Washington Post

Paramount+



Riding the Bull or the Bear

Whether the global economy is set for a sustained economic downturn or imminent renewed growth, subscription businesses don't have the luxury to wait and see before taking action.

The players who plan for both scenarios, and who make the right strategic choices for their businesses, will reap the opportunity to take market share or maximize their profit margins. We believe it's possible to develop a plan to futureproof a subscription service business in any geography, for whichever way the market moves, by considering these key factors:

THE CUSTOMER

Know the customer - which customers are, for example, the most financially challenged or value focused and at the greatest risk of churning? Who can be migrated to higher price tiers with expanded propositions, and who is a dormant or low frequency customer who might be prompted to cancel in the wake of a price increase?

Segment them well, and you can develop pricing, proposition and retention strategies to maximize both your subscriber numbers and average revenue per user (ARPU).

THE PERCEIVED VALUE

Know how necessary and unique your service is to the customer - how hard would it be for them to live without it, replace it, or trade down?

Understand the value of your service or product to different customer groups and you'll recognize the level of price adjustment they will tolerate.

THE ALTERNATIVES

Know the competitive landscape - how strong is the direct competition to your business? Are there substitute services and how attractive are they to the customer? How might they respond to changes you make in pricing and proposition?

Consider likely competitor moves when planning changes to pricing, proposition and offer strategy to make sure you stay ahead.

THE PLATFORMS

Know the extent to which your routes to market constrain your ability to flex - how do the parameters and functionality set by platforms such as Apple or Google constrain your ability to flex your pricing, communicate with customers, and retain them at the point of churn?

Factor in these constraints to mitigate their implications for your pricing, proposition, and churn reduction strategies.

THE KPIS

Know the key parameters of your business - how are you being judged? Are your investors most interested in subscriber growth, ARPU or cashflow?

When hard decisions need to be made, prioritize for what's most important.

THE CASH

Know the financial position of your business - how able are you to invest through this economic cycle to capture market share? How hard will inflation of your cost base bite?

Set clear parameters to assess the viability of your future plans.



Five ways to flex and futureproof

There are five actions we believe subscription businesses have available to them - two for immediate action, one to plan for, and two to consider for the future.

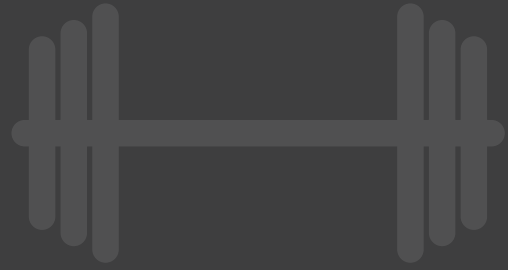
1 Do: Get ahead of churn

Some consumers will be looking at where they can trim some fat from their spending. Knowing this, it's far better to pre-empt churn rather than waiting until customers try to cancel to take action; or worse, spending to re-acquire them later on. This is a particular concern for businesses where ending a subscription is as simple as five taps on the phone (for example, billed via Apple) or cancelling auto-pay.

Rich customer data is key to this. It provides a basis for analytics that can cluster different customer groups, analyze their behaviors, understand their usage patterns and assess their potential lifetime value. Armed with this customer insight, it's then possible to tailor the approach and messaging for specific groups and effectively reach out to consumers - before they decide to say goodbye.



CASE STUDIES



POWER OF CUSTOMER ANALYTICS: GYM TARGETS HIGH-CHURN-RISK SEGMENT

Usage pattern	Frequent			LOW CHURN
	Occasional			
	Never	VERY HIGH CHURN		
		New	Established	Mature
		Customer stage		

A leading gym operator analyzed its customer data to detect cohorts at higher risk of churn. It discovered that a significant portion of new members had never visited a gym; and that this group was much more likely to churn. Based on this insight, it launched a campaign (direct outreach, special events etc....) to encourage these members to visit the gym for the first time. This targeted campaign was incredibly successful and led to a material reduction in churn.



CASE STUDIES



LESSONS FROM ROADSIDE ASSISTANCE

Data-rich businesses such as insurance and roadside assist providers have been providing tailored pricing based on propensity to churn for years.

For example, roadside assistance businesses have sophisticated models to understand propensity to pay and churn. A key insight they found was that one of the best indicators of low churn risk was the customer having used the service in the last year. The company adjusted renewal pricing so that these customers were offered higher renewal prices than customers who had not needed to use the service.

2 Do: Tailor your retention offer

Every time a customer contacts a business to cancel, there's an opportunity to "save" them with a targeted and intelligent retention offer. Discounts, subscription pauses, trade-down options and free upgrades are some of the options in the toolbox, but they depend on the business having both the flexibility and functionality available in the underlying product and proposition to be able to offer it.

Once again, sophisticated customer data is vital to the effectiveness of this action. There's a difference between retaining a customer and, for example, "training" them to call and cancel in favor of a new deal every time their offer expires. If a new deal is always guaranteed and word spreads on discussion forums, businesses risk having an increasing number of customers on discounted plans. Good data and insight will help to strike this balance.



CASE STUDY



CUSTOMISED RETENTION JOURNEYS

In order to cancel Audible, customers are funneled through a digital cancellation journey. This asks for the reason for cancellation. Depending on their answer, Audible presents a tailored response designed to retain them as a customer:

- **Can't find the book I like** - showcases a curated list of most popular audiobooks
- **Don't use it enough** - suggests audiobooks and podcasts for different occasions or time slots
- **Technical problems** - refers to the customer support line

If the customer still wants to cancel, they are reminded that they will lose their existing credit and shown a range of alternatives: Pause, Short term discount or Free Credit.



3 Make a plan to: Play with pricing

Businesses with a single price point can choose to increase prices - to drive margin and to balance the resulting likely churn against revenue uplift; provide deep discount introductory offers - to capture market share and drive out competition; or hold prices constant - giving customers certainty during times of economic uncertainty.

Businesses with tiered pricing have more to play with to drive both subscriber numbers and margins.



Power of tiering: How Netflix evolved its pricing to drive growth

NETFLIX - EVOLUTION OF PLAN TIERS AND PRICING; US

	2011	2022
TIERING STRUCTURE	TIER 1 Standard Cost: \$7.99 Stream quality: HD Number of screens: 2	Basic with Ads (New from Nov 2022) Cost: \$6.99 Stream quality: 720p HD Number of screens: 2
		Basic Cost: \$9.99 Stream quality: 720p HD Number of screens: 2
		Standard Cost: \$15.49 Stream quality: 1080p HD Number of screens: 2
		Premium Cost: \$19.99 Stream quality: UHD Number of screens: 4

In 2011, Netflix had a single price point for a single offering. Since 2013, the business has grown its ARPU by 45%, even as it has rolled out to more countries with lower price points. This has been achieved by offering more content and functionality, and by tiering its pricing, retaining an entry level price point for the more price sensitive, and providing options to upsell for those with more to spend. When Netflix introduced an advertising tier in November 2022, the consumer impact and messaging was smoothed by the existing structure of their pricing and proposition.

4 Consider: Bundling with others

Partnerships with another aligned business, when done well, can be a successful way to grow market share. Banks have bundled insurance and lifestyle products into their premium bank accounts to justify their monthly fees. Entertainment services have long been bundled with broadband and phone offers - providing more value for customers, and improved retention for businesses as customers have to opt out of the whole bundle to leave.

Today, this has evolved to the bundling of subscription video-on-demand (VOD) and music apps with fixed and mobile operators. This helps the subscription VOD provider drive up that all-important subscriber number, as well as decreasing levels of churn.

These partnerships are evolving beyond the traditional telco-media axis. Spotify has itself become a bundler, integrating Hulu and Showtime into its low-priced student account, no doubt in the hope of capturing a younger generation as they form their subscription habits. Lyft is offering free Grubhub+ membership to its Pink members. This benefits both parties: it extends Grubhub's customer base and encourages them to use Grubhub over other food delivery services and enhances Lyft Pink's perceived value to its subscribers.

STRATEGIC BUNDLING PARTNERSHIPS ARE EVOLVING, WITH SOME SUBSCRIPTION PROVIDERS TAKING THE ROLE OF BUNDLER

	BUNDLE PROVIDER	BUNDLED SUBSCRIPTION SERVICE
FIXED TELCO / TRIPLE OR QUAD PLAY BUNDLING		
MOBILE TELCO BUNDLING		
BANK ACCOUNT BUNDLING		
EMERGENT BUNDLING		

The right strategic partnership plays to the strengths of each partner in a way that aligns their mutual interests and delivers strategic value on both sides. Reaching out to forge creative new alliances has the potential to attract and retain increasingly value-conscious customers who may otherwise be facing subscription overload.

5 Consider: Making an acquisition

Times of economic uncertainty can give rise to interesting acquisition targets. Recent economic uncertainty has led to a period of market adjustment on valuations, with sellers and buyers both in the process of adjusting their expectations. With this in mind, it's worth looking for opportunities to acquire competitors who may have more limited access to capital, or who are finding it difficult to fund the expensive scale-up growth phase.

Mergers and acquisitions have the potential to bring a step change to your business, opening up new geographies and turbo-charging the growth of your subscriber base, which in turn enables new synergies to emerge.



The future is uncertain, but with decisive action and a clear strategy, there's much to be won. The decisions you make now have the potential to defend - and grow - your customer base; there are opportunities to capture market share and grow margins.

To get ahead of your competitors, there is no time to wait and see how the economic winds will blow: **...the moment to act is now**

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About OC&C

OC&C is an international strategy consulting firm, focusing on core specialisms with over 30 years of experience in unpicking the most complex business challenges with simple, uncommon sense™.

Spanning 10 countries worldwide, our firm is made up of over 125 agile thinking partners and 700 employees.

This article draws insights across our TMT, Retail, Consumer and Analytics practices.

Our intellectually curious team are here to help clients with customer segmentation powered by data and analytics, retention strategies, proposition and pricing redesign, strategic partnership evaluation and strategic deal support from target mapping to commercial due diligence.



To share your experience, to start your strategy shake-up, or continue the discussion, please get in touch

Kim Chua
kim.chua@occstrategy.com

Michael Lisowski
michael.lisowski@occstrategy.com

Sebastian Blum
sebastian.blum@occstrategy.com

Ye Chen
ye.chen@occstrategy.com



OC&C
Strategy consultants