



Reflections

Friday, April 23, 2021

Welcome to the “subscription economy”

The subscription economy is growing like gangbusters. More and more of the goods and services that we buy can now be subscribed to. For companies, subscriptions are an effective sales model that reduces their costs and increases predictability. For us consumers, they are convenient. The risk with subscriptions is that they make us passive and less inclined to continuously compare prices. In the long run, this may lead to a weakening of the internet’s price-lowering function.



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We are making more and more of our purchases online, but besides that, there is also another strong trend that is not talked about as much: We are also buying more and more in the form of subscriptions. Most people already subscribe to a streaming service such as Netflix or Spotify, instead of buying DVD movies or CDs as in the past. Cloud storage services are rapidly replacing the need for physical hard drives. The days when you bought apps for your phone are past. Today it is more and more a matter of subscriptions instead. Computer software is also rapidly changing from something that we once owned to something we now often subscribe to. We buy fewer and fewer physical books; instead we subscribe to services like Storytel or Audible.

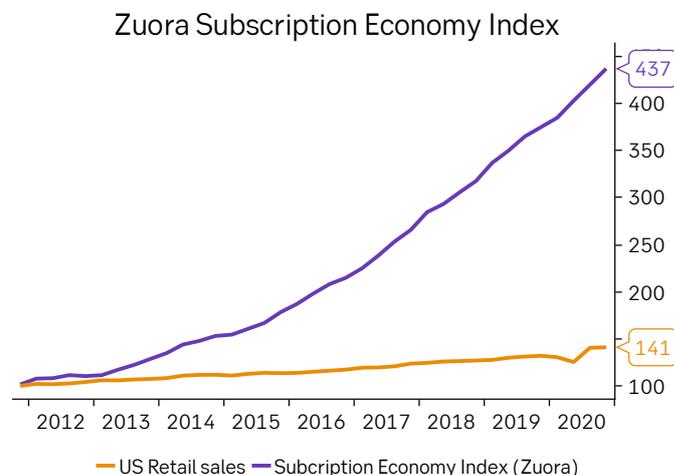
Not just digital services

But subscriptions are not just about things that can be distributed digitally. Subscribing to a food box service instead of shopping in stores is becoming more common. Many people speculate that cars will be the next big thing we will start subscribing to, instead of owning like today. Wine, coffee, vitamins, beauty products, contact lenses, razor blades, toilet paper, flowers, cat food, clothing and glasses are other examples of products that companies now want us to subscribe to instead of buying when the need arises. Gartner Research estimates that within a few years, three quarters of companies that sell directly to consumers will offer some form of subscription to their products.

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The subscription economy is growing like gangbusters. The American company Zuora, which handles invoicing services for the subscription offers of various companies, continuously measures the sales growth of their customers' subscription products. Sales volumes have grown very rapidly. Since 2012, they have more than tripled, as opposed to overall US retail sales, which have "only" grown by some 40 per cent during the same period.



There are several reasons why companies push the subscription model so hard. Subscriptions provide smoother and more predictable revenue. They make inventory management and logistics easier. A company can develop a closer and better understanding of its customers' needs. Last but not least, it will also be cheaper in the long run, since loyal subscribers require much less marketing than repeatedly attracting new customers for one-time purchases.

Do subscriptions decrease the internet's price-lowering effect?

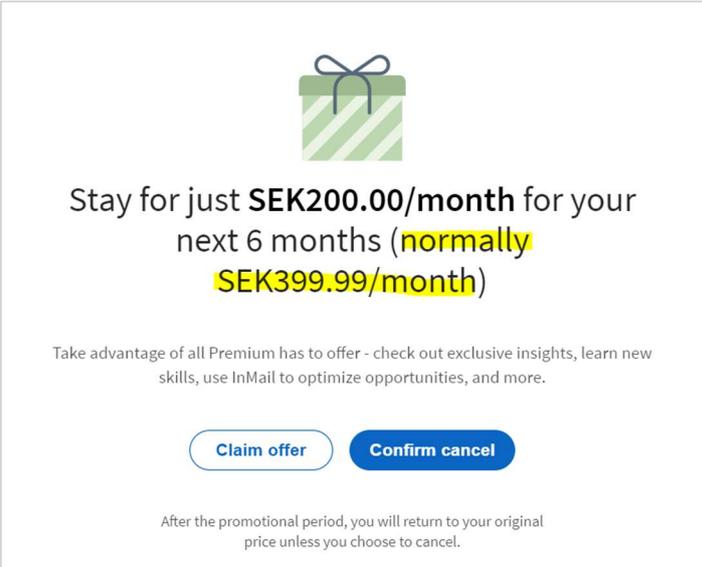
For us consumers, one advantage of subscriptions is that they simplify our everyday life and enable us to save time. But there are also disadvantages that many people may not think about.

When we proactively compare prices online before buying something, we also ensure that we get the best price. But when we buy a subscription, this proactive price comparison only occurs when we sign up. Then our purchases simply continue, until we say otherwise. After a while we can no longer be sure that the price we pay is competitive. Perhaps a cheaper supplier has entered the market, or perhaps the company has lowered its prices for new customers without doing the same for existing ones.

This kind of differentiated pricing is something that probably every company dreams of. Being able to charge different prices – so that customers who are willing to pay more are charged more than those who are less willing to pay – obviously works wonders for margins and profits. But this is easier said than done, since prices tend to become widely known. It has become even harder as e-commerce has spread. Today, consumers can efficiently, easily and rapidly compare prices online and shop where it is cheapest. This has led to a major increase in consumer power and has contributed to strong downward price pressure worldwide.

But since subscriptions tend to result in more passive buying behaviour by us consumers, it also becomes easier for companies to get away with charging different amounts to different customers. Existing customers often do not automatically benefit from the price cuts a company may need to offer in order to compete for new customers (but they will probably be hit by any price increases).

I recently ended my paid subscription to a very well-known social professional network, since I felt it was too expensive considering what benefit I gained from it. I was paying SEK 499.99/month. Immediately after I pressed the "cancel subscription" button, I received a six-month offer for only SEK 200/month if I stayed as a customer. There is nothing unusual about that. This type of temporary discount is common. What disappointed me was that the company also informed me that the temporary discount represented a large saving compared to the normal price of SEK 399.99/month (!) What? SEK 399? I had paid SEK 499. Of course it is hard not to feel a little cheated in that situation.



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This is not a new problem for consumers. E-subscriptions and insurance are two examples of areas where customers must continuously evaluate different companies in order to make sure they are getting the best price (and many of my readers would probably want to add mortgages among examples as well).

But looking ahead, there is a risk that this problem will grow as more and more of what we consume is in the form of subscriptions. In order for us to retain the consumer power that the internet has granted us, we must continue to proactively compare prices and continuously search for the best deal.

The movement towards a subscription economy may thus go hand in hand with less proactive consumers and lead to a reduction in the internet's price-lowering function. But even tech giants that are well-adapted to the existing e-commerce model have reason to watch their step. Companies like Google and Facebook rely largely on advertising sales today. They will not benefit if, in the future, we choose subscriptions for goods and services to a greater extent. Subscription providers have a significantly smaller need for continuous advertising, since more of their marketing budget will go towards building longer-term relationships.

A lot of things will change if subscriptions – for better or worse – become a larger and larger share of our consumption. We consumers will simply have to hope for new apps that will continuously scan the market for subscriptions and will automatically switch us to the cheapest. In any case, that is one service I will choose to subscribe to. 😊