THE SUBSCRIPTION CONTRACT GUIDEBOOK

TYPES, USES, AND PROS AND CONS

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Introduction

While the subscription industry is booming and more companies are moving to subscription models for software, services, and even product memberships, there are a number of factors that need to be considered when deciding on what kind of subscription contracts to offer.

Subscription contracts are often complex, as they need to effectively balance customer needs and expectations with business profitability, cash flow, and secured revenue - all while taking into consideration subscription terms, pricing, and billing periods.

Creating a subscription model and determining which contracts are right for your business takes time and evaluation. But with the proper knowledge about the types, uses, and benefits of some of the most common contracts being used today, you can be better prepared to make those decisions.

WHAT IS SOLD?

The first thing to consider when determining your pricing and contract types is what your company is actually selling. This will often be the basis for determining how you will charge your customers.

The one and only service -For companies that offer only one product or service that is basic and straightforward, it would be more common to have blanket flat rate subscriptions.

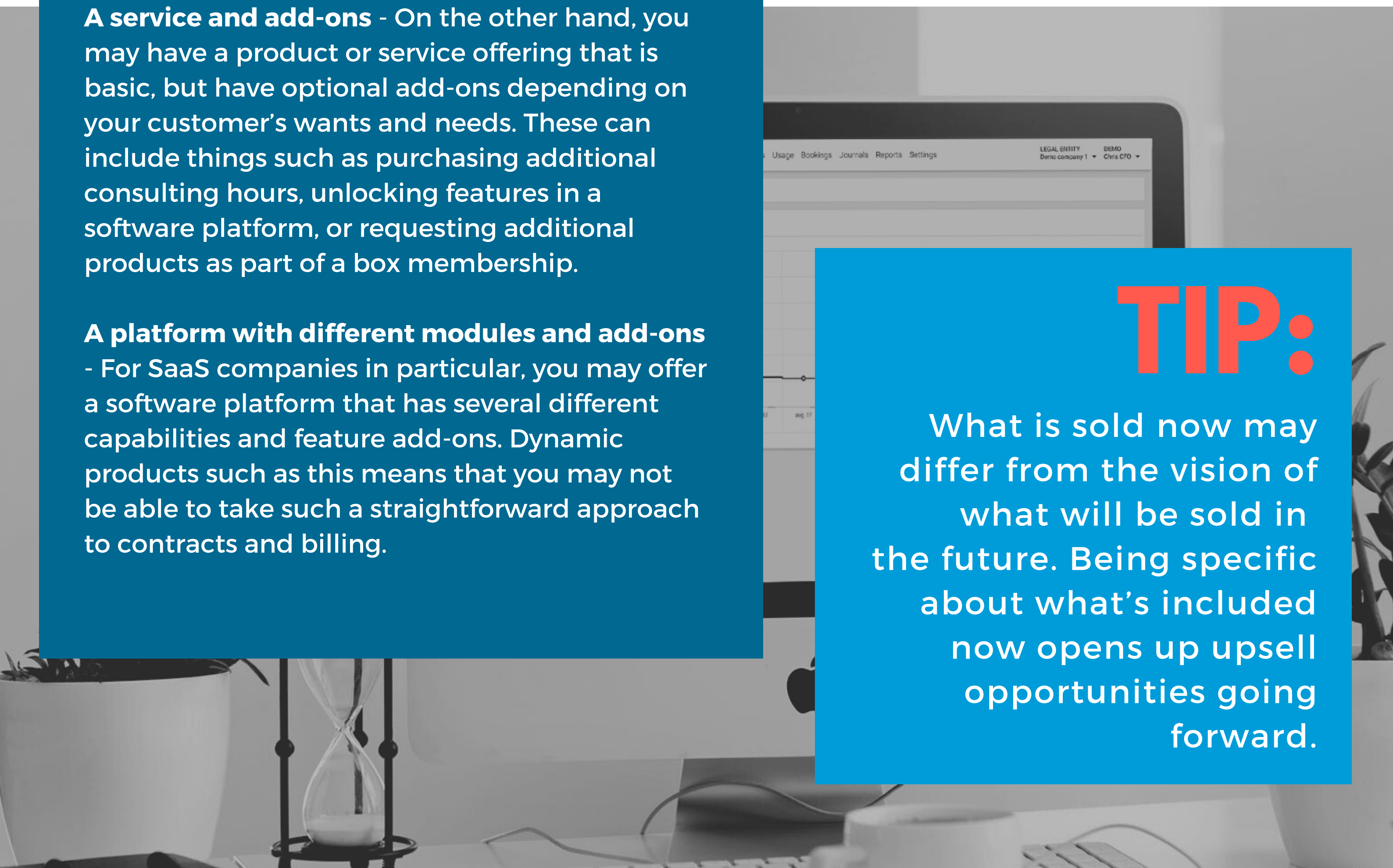
Most commonly seen with B2C companies, subscription boxes, or streaming services, flat rate subscription pricing isn't contingent on levels, usage, pricing tiers, or feature add-ons. With flat rate subscriptions, fees are predetermined and have little variation in terms of customizable add-ons, usage, or access.

A service and add-ons - On the other hand, you may have a product or service offering that is basic, but have optional add-ons depending on your customer's wants and needs. These can include things such as purchasing additional consulting hours, unlocking features in a software platform, or requesting additional products as part of a box membership.

A platform with different modules and add-ons - For SaaS companies in particular, you may offer a software platform that has several different capabilities and feature add-ons. Dynamic products such as this means that you may not be able to take such a straightforward approach to contracts and billing.

For example a software solution for marketing and sales may offer the basic platform for free, but charge for accessing additional tools for marketing automation, or charge for extra dashboards for metrics reporting.

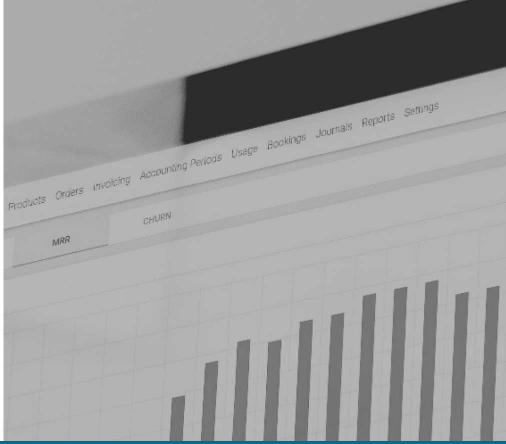
Multiple services/products - Sometimes subscription businesses offer an array of services and products, each with their own capabilities and add-ons. In these complex situations, you can take different approaches to how you charge based on factors such as usage, seats, customer revenue, or other data points, which we'll discuss in further detail later.



TIP:

What is sold now may differ from the vision of what will be sold in the future. Being specific about what's included now opens up upsell opportunities going forward.

WHAT IS THE MARKET?



After determining your product or service offering and how dynamic it is, you need to think about your customer profile and actual volume of customers you intend to have - or need for your business to be profitable. For your particular business, do you expect to have a higher volume of low paying customers, or fewer high paying customers such as enterprise businesses? This can vary based on what is sold, your target audience, and between B2C and B2B offerings.

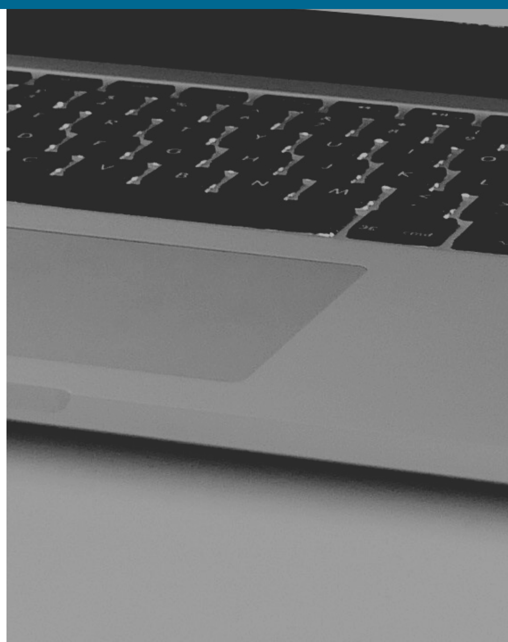
Long tail
With the long tail approach, you will typically target more customers in broader industries or with varying profiles. Because of a higher volume of customers, you focus less on large contract agreements with more complicated terms, and more on quick onboarding, streamlined sign-up, and straightforward product or service delivery.

Long tail targeting is highly standardized - there is often far less variation between offers, and pricing also tends to standardized depending on what is sold and the value of goods and services. With long tail targeting, companies may choose to focus on simplicity over maximizing the total amount for each deal made, perhaps increasing the total amount of customers rather than increasing the average revenue per account (ARPA).

Fewer high-paying customers
On the other hand, you may have a complex software solution and you target large enterprise businesses. In this case, you would likely focus on fewer customers that pay a larger fee, or have more dynamic subscriptions.

With these kinds of markets, you likely offer more customizable solutions and pricing schemes, rather than something standardized. Especially if what is sold is more complex, such as a platform with different modules, or multiple services/products, you want to focus on balancing simplicity with getting the best deal possible. Meaning you can reduce the number of sales you make, when securing higher price points, which in turn would mean maximizing your ARPA.

When you've decided what type of market you will target, you next need to think about what will actually drive the price of your subscription, and how to determine the value.



WHAT IS THE PRICE DRIVER?

Every business must determine what is their unique selling point in order to convince customers of their value. But for subscription businesses, you also need to consider value as a way to determine what will drive the price of your subscription. Take the products or services you're selling and what kind of customers you intend to have, and find the element of pricing that makes the most sense for those conditions. These include:

Pricing based on seats
A very common practice in subscription model businesses is to charge based on user count. For both B2B and B2C companies, it can make sense that pricing is determined based on how many people will actually be accessing the subscription. For enterprise customers in particular this can make a lot of sense, as the number of users can be in the hundreds. Because of this, it would be necessary to charge them significantly more than a customer who may only need five access accounts and is less of a strain on your own resources.

When it comes to consumer facing subscriptions, user pricing may also make sense because customers can feel that they get a better value for sharing an account with family and friends.

In some cases, charging each and every user individually may make customers feel that they don't get enough use out of a product or service to make subscribing worthwhile, depending on what it is you are offering them.

Pricing based on features
With SaaS products in particular, many price their subscriptions based on features that are "unlocked" as fees increase. Pricing tiers may begin with a "freemium" plan, where users may access a very basic version for no fee at all. In doing this, businesses can entice subscribers to upgrade to paid versions, in order to access more capabilities once they enjoy using the product. As subscribers become familiar with the product, they can tend to want greater access to all the features available, and as such are willing to pay more.

The benefit of creating pricing tiers based on features is that you position elements of your products or services as having a clear value that can be measured monetarily. You can appeal to a wide audience of users with varying needs and budgets, simply because you offer choice by way of price and access. You may find that some users only want the premium features, and others are quite satisfied with the basic version. But by utilizing pricing tiers, you are allowing for freedom of choice, which can also be beneficial for customer perception.

Pricing based on transactions
Particularly if you are in the B2B industries, perhaps you will charge your customers based on how many transactions are completed through your service or platform. For example, an invoicing service may charge based on how many invoices are sent per month. In this case you can charge a flat fee up to 10 invoices in a month, or perhaps you charge per invoice.

Similarly, maybe you charge per email or SMS sent through your service. But essentially, your fee should ensure that you are able to at least cover your own service fees and costs.

Pricing based on customer revenue/cost/KPI
When it comes to B2B industry subscription businesses, pricing may be determined based on a system for customers' individual revenue or resource spend in a particular area. This could mean that you price your product based on a percentage that is the same for all customers, though the actual fee being charged differs.

Say you have an employee management tool that you are offering to B2B subscribers. You could charge a percentage of what your customer spends on employee salaries. This way, when the company grows, the fee you receive naturally increases as your tool is used to manage more employees.

Or, if you have a platform that can directly help your customers increase their revenue and profit margins, you may want to consider charging a percentage of that revenue, since you may be able to see a direct impact for your customer's return on investment. If your platform helps a customer improve revenue, then it can make sense that you take a share of that increase.

You may want to consider this pricing model if you are considering that you can service various sizes of companies while taking a fee that is proportional to each customer.

TIP:
You may have several different ways you could price, but think about your unique selling point, and how customers can relate your price to the greater value you'll provide.

Pricing based on time
With a flat-rate system, access is typically unlimited for a set scope of features. With usage pricing based on time, customers pay for utilizing a product or service within a predetermined scope of availability, or for only what they have actually used or the amount of time they have used it.

What this means for a metered pricing model for example, would be a customer pays based on the number of hours they've been on a given platform. For an educational video streaming service, for instance, a customer who watches four hours of video one month, would only pay for those four hours.

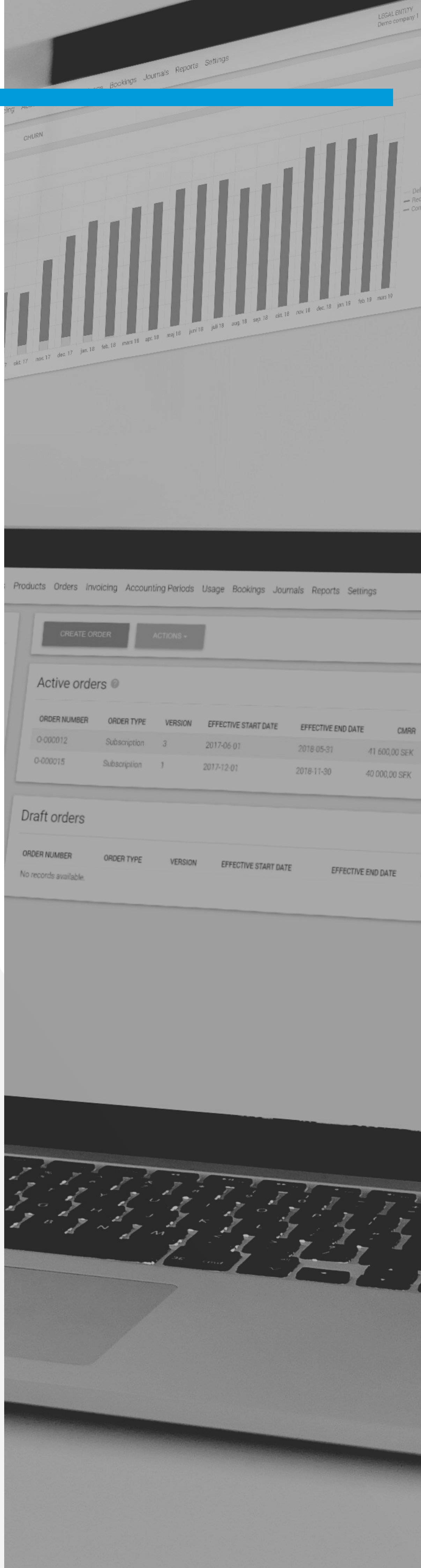
Pricing based on caps
Pricing with caps is similar to pricing based on a predetermined period of time. Essentially, you are charging access to your subscription up to a certain point.

This varies greatly with what you are offering. For example, a platform for conducting search engine optimisation research may allow a certain number of keyword searches per day at a particular rate. The cap is a maximum number of searches.

Other things to consider about usage pricing: usage pricing can give customers more specific valuation when it comes to paying for what they get. When pricing is metered, or based on an incremental value, customers can potentially better understand what it is they are paying for. As a company, you should consider what potentially fluctuating revenue will mean for your own operations and cash flow.

TIP:

Don't forget to straight out ask some of your trusted customers or potential customers what price structure they would expect from you and explore their "whys".



PRICING ARRANGEMENT

Next, consider what your pricing arrangement with each of your customers will be in regards to charge types and pricing model.

Charge Types
Different pricing terms and contract lengths are not the only consideration you'll need to take for your subscriptions. You also need to decide how frequently, and when you will actually charge your customers.

One-off - One-off charge types can be used for a variety of charges, and in combination with other types of charges. For example, perhaps you will charge your customers a recurring monthly fee for your service, but you require a one-off charge for onboarding and set up. Or, one-off charges can be added to other types of charges for in-app purchases, add-ons, or additional products when applicable.

Recurring - Or you may choose bill customers on a recurring basis. This may be monthly, quarterly, or any other periodical charge set to a regular schedule. With recurring payments, your cash flow is also spread throughout the year, and customers may have to worry less about their own liquidity if an up-front charge is a large investment for them.

You may opt to offer customers both a one-off, or recurring fee option for payment, though typically the up-front fee will be less than the recurring fee when combines.

Metered - Metered charge types refers to those where a customer is billed based on a measurable condition. In this case, terms may be set for billing periods and contract length, but the actual price is not predetermined. For these, the cost is calculated later, and billing happens in arrears.

This is typically done in the instance of usage rates and transactions. For example, going back to the instance of an invoicing software: Perhaps you charge your customers for a certain time period, for however many invoices are sent in that period. In this case, if you are to bill quarterly, some customers may pay for two invoices sent during one period, and 10 sent during the next.

For metered charges, there may be less of a consistency in payment, however you are ensuring your customers pay exactly for what they are getting when they get it.

Price Models
Now in addition to charge types, you need to determine what your pricing model will be. This is essentially articulating how your customers are charged in combination to when.

Flat pricing model - With a flat pricing model, you typically charge one set fee for your products or services. This model is most common for companies who are selling one product or service in the long-tail market, as it is the simplest pricing model. Tv and movie streaming services are an example of subscriptions businesses that utilize the flat rate model.

Volume discount and tiered model- For volume discount pricing models, you may choose to use an algorithm to determine a discount for customers as they increase their usage, seats, or other value factors. Instead of charging more incrementally, you may offer a discount that corresponds with the increase of the subscription.

For tiered models, on the other hand, you may have different prices according to incremental increases based on other factors. For example, you can have one price that you charge customers for the first 10 users, and a different price for the next 25 users, on top of that initial 10. For tiers, you may also mix flat fees and per user fees.

Feature plans- In some cases, your plans may be based on features that are “unlocked” as fees increase. Feature plans may begin with a “freemium” option, where users may access a very basic version for no fee at all. In doing this, businesses can entice subscribers to upgrade to paid versions, in order to access more capabilities once they enjoy using the product.

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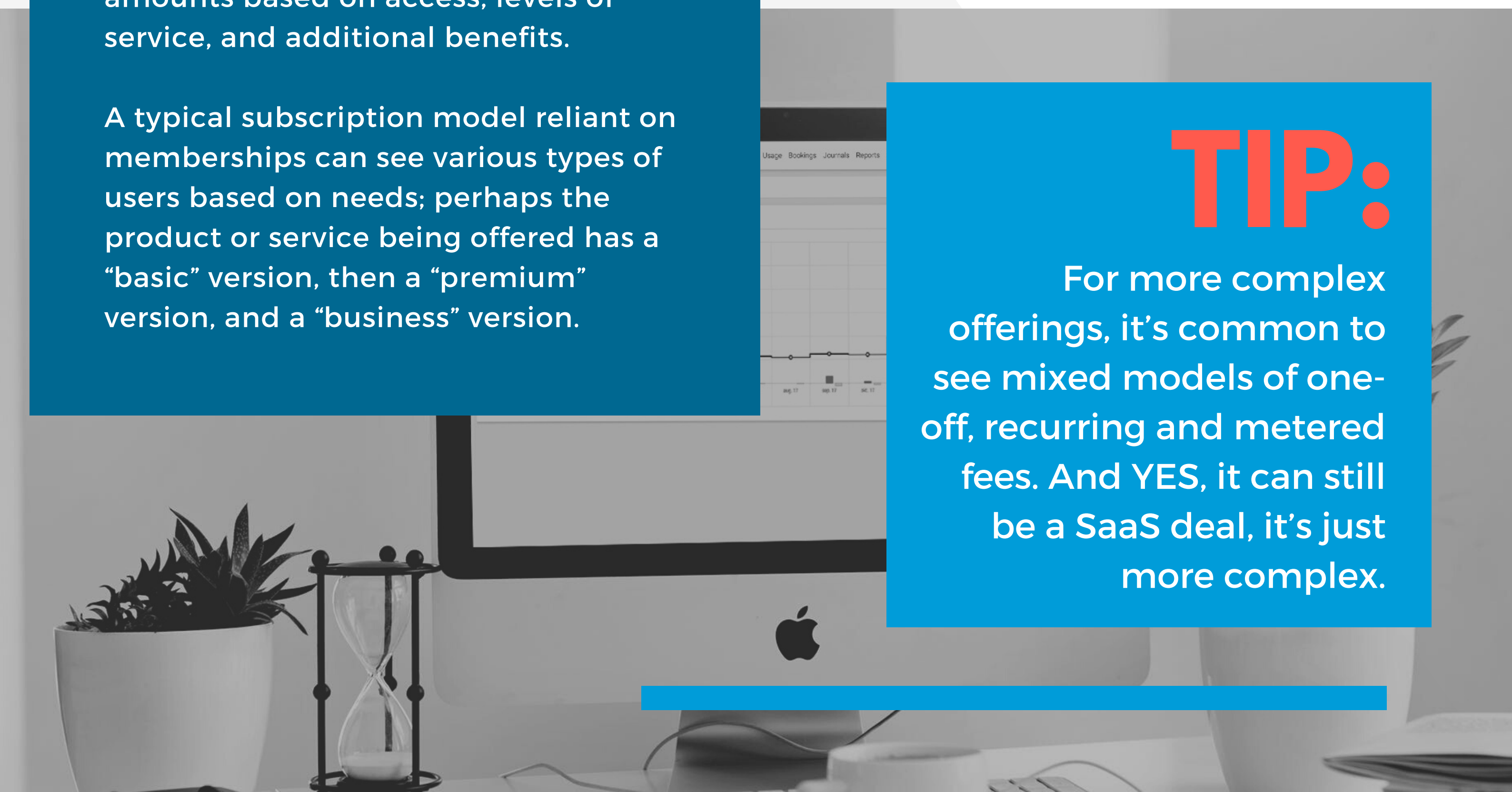
Membership model - Similar to pricing tiers based on features, membership levels often see users paying in varying amounts based on access, levels of service, and additional benefits.

A typical subscription model reliant on memberships can see various types of users based on needs; perhaps the product or service being offered has a "basic" version, then a "premium" version, and a "business" version.

In this way, access to features or elements of the products or services may not incrementally increase, but there may be different functionality or concierge services based on the needs of the user or what they may be actually using the product or service for.

Some benefits of using a pricing model based on memberships is that you can focus heavily on loyalty programs and customer service, as well as segment your audience based on professional or private users.

Overage model - In some cases, such as with metered price drivers, you will have a price model that charges based on overages, which may incur fees at different rates than the original offer. For example, telephone subscriptions may include a set number of SMS, and overage fees kick in only after that predetermined amount.



TIP:

For more complex offerings, it's common to see mixed models of one-off, recurring and metered fees. And YES, it can still be a SaaS deal, it's just more complex.

CONTRACT ARRANGEMENT

After determining what you are selling, what type of market you will attract, how you value your products or services, how you will charge your customers, and what your pricing model will be, the final step is to determine what your contract terms will actually look like.

Depending on your industry and product or service offerings, you'll want to consider whether to have termed or evergreen contracts.

Evergreen Contracts
With evergreen contracts, there is no set or predetermined time when the subscription will end or contract needs to be revisited. Renewal effectively happens automatically without there being a need to recommit, and ends only when a customer actively cancels their subscription, or payment fails.

Evergreen contracts can have any number of charge types and billing periods, and renewal is determined when sign-up occurs.

Termed Contracts
Termed contracts naturally have an end date, at which time the pricing and renewal terms are often renegotiated. Terms can be quarterly, yearly, or even three years or more in length, and there are several reasons why.

When a company is able to sign on a customer for a three year contract, that is secured revenue for a much longer period of time. This enables better forecasting and cash flow prediction, particularly in comparison with an evergreen contract, which can be harder to predict.

Long term contracts also ensure that you can establish a good relationship with your customer, and sees them using your product or services over a time period where they may better be able to see the advantages or results from being a customer.

With either evergreen or termed contracts you want to determine how to identify opportunities for upgrades and upsells. You should also consider what will happen should your offerings change within a subscription term. For example, if you operate a subscription business as a software provider, you may want to consider what renegotiation will be available to your termed contract customers when you update your software, add features, or potentially discontinue others.

With termed contracts, subscription companies may need to be more on top of their customer data than they would be with evergreen contracts. This is because if you are not keenly aware of the end dates of all your contracts, you may wind up missing opportunities for renewals when the contract term ends.

TIP:

Even with auto-renewal clauses every company should monitor the renewal points closely and see them as opportunities to review customer needs and of course ensure renewals.

Conclusion

Subscription contracts aren't always simple and straightforward, and determining the best options for your business take a lot of consideration.

When identifying what contracts are best for your business, you should carefully balance your customer wants, needs, and expectations, with your own business goals, revenue expectations, and cash flow needs.

Once you properly evaluate what it is you are offering as a product or service, what market type you aim to target, what the value is of your products and services and what the price driver is, then you can think about the pricing arrangement in regards to billing periods and charge-types, and finally, what your actual contract terms will be.

As consumer expectations change, and markets become more competitive, it's important to be able to offer a good value and great service to your customers. Dynamic contracts and mixed terms may be a great way to provide this.