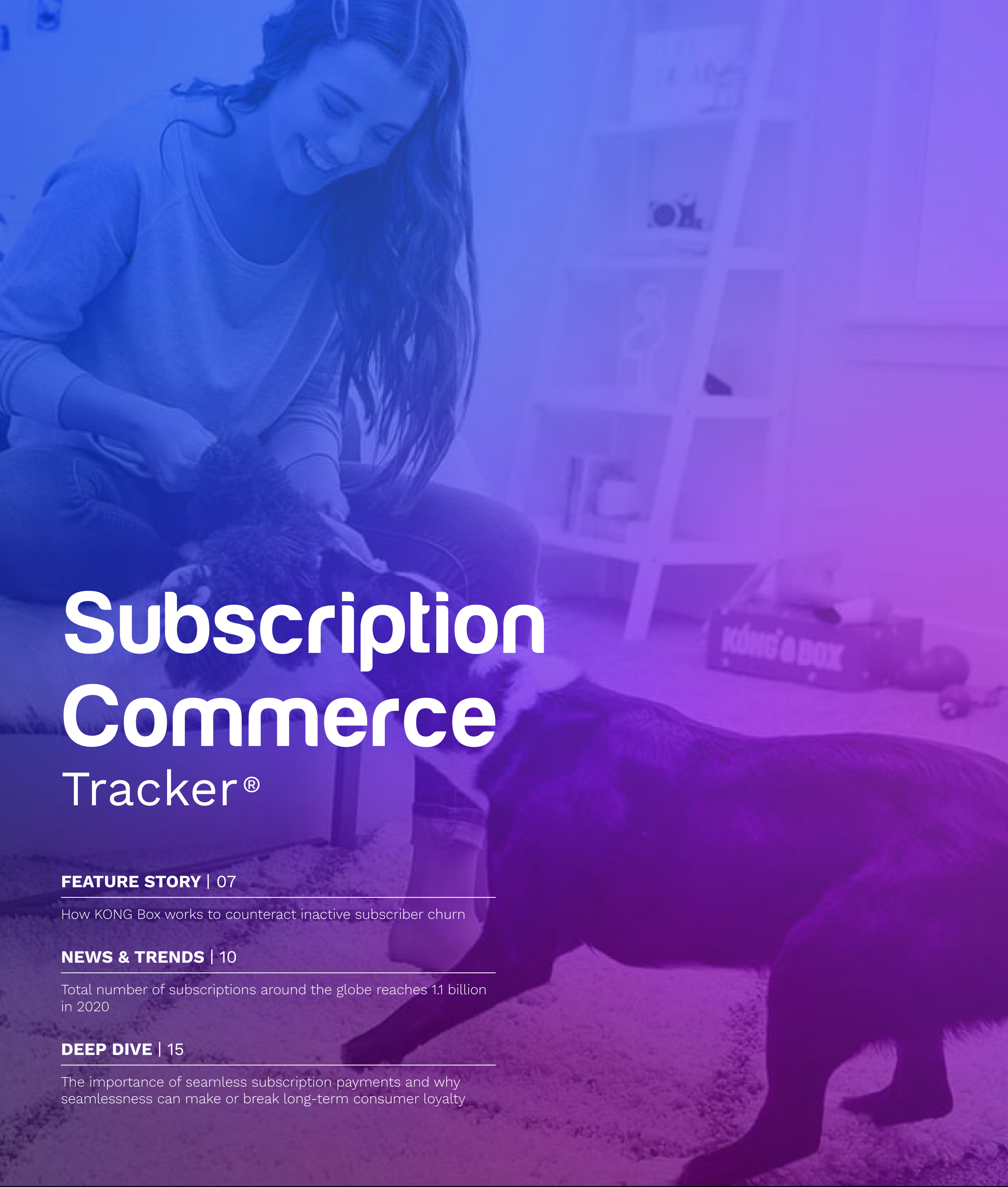

Subscription Commerce

Tracker®

APRIL 2021

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The Subscription Commerce Tracker® was done in collaboration with Vindicia, and PYMNTS is grateful for the company's support and insight. PYMNTS.com retains full editorial control over the following findings, methodology and data analysis.

What's Inside

It has been more than a year since the pandemic began, and consumers have radically altered their habits for everything from how they work to how they buy groceries. The health crisis has devastated many areas of the global economy, but one industry has managed to weather — and even thrive amid — the economic tumult: subscription services. The numbers tell the story: The United States alone added 15 million subscribers and 96 million new subscriptions between February and July of last year. Half of these new subscribers said they were "very" or "extremely" likely to retain their subscriptions after the pandemic ends as well.

This is not just an American phenomenon. Subscriptions are experiencing similarly robust growth globally, with recent research finding that consumers are turning to digital and physical subscription services in record numbers. A **report** by software and services provider Amdocs surveyed consumers in the U.S. and United Kingdom, revealing that 36 percent had added a subscription to an eLearning service and that nearly the same shares had added a video streaming or eHealth subscription. A different report tracking physical subscriptions found that 17 percent of U.K. consumers now **subscribe** to a monthly physical subscription offering of some kind, with 29 percent subscribing to food delivery services and 20 percent receiving shipments of beauty and grooming products. These physical subscriptions provide true value for these customers, too, as roughly 30 percent say receiving subscriptions feels nice and 22 percent say they appreciate that they do not always know what they will get.

The space is not without its challenges, however. Managing retention is still a major consideration for subscription providers, especially because consumers are becoming spoiled for choice as more companies enter the market. This means providers, whether they have long operated in the space or are new entrants, must examine the frictions their customers face and work to offer innovative and personalized services and payment options. Failure to do so could lead their subscribers to defect to platforms that offer superior experiences.

AROUND THE SUBSCRIPTION COMMERCE SPACE

The U.S. mobile subscription market offers one example of the space's robust growth. A recent **survey** revealed that one-third of American consumers have signed up for subscription apps, such as eLearning platform Babbel, streaming platform Netflix and on-demand music service Spotify. U.S. consumers between 35 and 44 years old showed especially high interest in these services, with 37 percent saying that they had signed up for one such subscription. Forty percent of respondents said that these services helped them relax, while 27 percent stated that the subscriptions helped them feel less lonely.

Subscriptions are also making their way into sectors that have historically leaned more on fixed-price business models, including the automotive industry. German automaker Volkswagen recently **announced** that it would trial a subscription service for its ID.3 electric hatchback, for example. The company believes entering the subscription space could generate annual revenues of more than €3 million ($3.5 million USD) by 2025, and it plans to test the new service in six German cities.

Subscription service providers in certain sectors are finding it difficult to eliminate some of their friction-laden habits, however. A recent **survey** found that just 41 percent of U.S.-based news publishers "make it easy" for their customers to cancel their subscriptions online, with many requiring subscribers who want to cancel to contact customer service representatives instead. Sixty percent of these organizations also ask their customer service professionals to encourage these subscribers to stay engaged, even though research shows that segmenting customers based upon their cancellation risks would help publishers better identify — and rectify — the pain points prompting them to terminate services.

For more on these stories and other subscription headlines, read the Tracker's News and Trends section (p. 10).

KONG BOX ON HOW IT WORKS TO CURB CANCELLATIONS AND INACTIVE CHURN

Pet adoptions have surged in the U.S. during the pandemic as consumers hunkered down at home and sought companionship with furry friends. The eCommerce pet market is booming as a result, with plenty of toy and treat subscription boxes to choose from for surprise-and-delight experiences that arrive at consumers' doorsteps. KONG Box from canine toy company KONG Co. is one such subscription service and offers treats, training toys and tips, including its famous rubber chew toys. In this month's Feature Story (p. 7), president Dan Probst of KONG Box details the hard lessons learned from an unsuccessful introductory promotion and explains how the company has worked to counteract cancellations with pause features and payment provider partnerships.

DEEP DIVE: HOW BUSINESSES CAN SUPPORT SEAMLESS SUBSCRIPTION PAYMENT EXPERIENCES

There has been a surge in subscription enrollment during the pandemic as consumers look to experience new products and services from the comfort and safety of their homes. Research has shown that many intend to keep their plans far into the future, yet a sizable share are still at risk of canceling their services once the pandemic ends. Many say that they want to end their subscriptions because they do not have the flexibility to change their plans, revealing that providers must do more to meet their needs. This month's Deep Dive (p. 15) examines how businesses can tailor their subscription models to retain customers by focusing on personalized payments experiences and standout features.

5 FIVE FAST FACTS

51%

Share of streaming service consumers who signed up during the pandemic who are likely to keep their services

44%

Portion of consumers who would be likely to pause rather than cancel their subscriptions if the option were available

50%

Share of consumers who subscribed to a service after the pandemic began who said they will very likely keep their subscriptions

63%

Portion of digital media services subscribers who were unlikely to cancel their services before the pandemic

60%

Share of merchants who have improved their sign-up processes and reduced the time it takes for subscribers to access their services

Source: https://www.pymnts.com/wp-content/uploads/2020/11/Subscription-Commerce-Conversion-Index-November-2020.pdf

Feature Story

HOW KONG BOX WORKS TO COUNTERACT INACTIVE SUBSCRIBER CHURN

More than 63 million U.S. households own a dog, according to an American Pet Products Association survey from 2019, a number that has surely increased within the last year, as adoption rates rose by 15 percent in 2020. Many consumers hunkering down and working remotely have sought companionship during the pandemic by welcoming new furry friends into their homes, and animal shelters have struggled to keep up with the demand.

The U.S. pet industry is not surprisingly booming, with the online pet market almost quadrupling since 2013 to reach its current worth of $99 billion. Online shopping has surged within the past year as consumers avoided risking unnecessary exposure in public spaces and looked for convenient ways to obtain new products and services. Subscription boxes provide consumers with the surprise and delight of trying new items from the comfort of home, and many pet boxes have entered the market to offer toys, treats and gear.

Canine toy company KONG Co., which sells toys in more than 80 countries, is one such pet brand that jumped on the subscription bandwagon two years ago with its KONG Box. Monthly subscription plans start at about $40 per box and include treats, training toys, tips and recipes. Classic KONG balls are durable rubber chew toys with holes through which pet owners can insert kibble for enrichment. The idea for the company, founded by Joseph Markham in 1970, came when his dog Fritz chewed on a rubber part while Markham was repairing the suspension on his Volkswagen Bus.

"We really wanted to make this fun and get these toys into customers' hands on a regular basis," president Dan Probst of KONG Box told PYMNTS in a recent interview. "It's fun having items that maybe you wouldn't normally buy or didn't even know existed conveniently show up. We have built this business where it is more than a subscription and more like a membership that you join and get lots of benefits."

CUSTOMER RETENTION

KONG Box had a shaky start. One of the promotions the company tried to entice customers with was to offer their first box for $1 if they enrolled in a subscription. A blogger encouraged dog lovers to sign up with a prepaid Visa card and then cancel to receive their dollar boxes.

"It was a major blunder that cost us just under $1.8 million," Probst said. "We're continuing to learn."

KONG Box has since learned its lesson and no longer provides introductory offers. Doing so has helped the business move away from "fly-by-night customers" and into the right direction, Probst said.

As with many subscription services, however, customer turnover, or churn, is one of the metrics Probst has to keep a close eye on. Plan cancellations are just one data point he analyzes. The other, which he calls passive or inactive churn, happens when a customer's credit card fails.

"These customers didn't actively go in and cancel their subscriptions, but by default they are now in this weird state where they have not canceled, but they're not active," he said. "We have to really understand our numbers and delineate between who is an active paying customer and who is inactive."

KONG Box has adopted a solution to this from a payment provider that kicks in when customers update their card information on other platforms. The solution then updates the card details on KONG Box's network, and as a result, 600 credit cards are updated monthly. The provider works with card networks and automatically attempts to update saved card details whenever a customer receives a new card to replace an expired card or one that is reported lost or stolen.

The other way to combat churn, Probst said, is to allow customers to pause their subscriptions.

"They could pause indefinitely, which we don't want them to do," he said. "But customers must contact customer service, and we will implement a three-month pause."

ANSWERING CUSTOMERS' CALLS

KONG Box is integrated with Shopify, the Canadian-based eCommerce platform for online stores. The network is seamless, but Probst said there are some limitations. If a customer orders a subscription but wants to add an extra item, it creates a challenge, for example.

"It becomes tricky — a customer can't just add something into the box," he said. "Some competitors or other providers do allow for those kinds of customizations. We're trying to do some workarounds, where a small item can be added but won't disrupt the volume metric of the box. That's one of the struggles that we have: We can't upsell to add to the box."

KONG Box has established a separate Shopify site for individual purchases to help meet demand for specific items. This appears to be working: Probst said the company is profitable this year and expects to make back all the money lost through the original promotion by the close of 2021.

"Obviously you can't turn around an ocean freighter quite as easy as a speedboat," he said. "But we're definitely course-correcting."

The subscription services sector has not only survived but also thrived amid the pandemic as consumers more often prefer to receive goods conveniently at their doorsteps. Subscription companies that partner with seamless payment networks and work to maintain retention from different angles will be able to keep the ball rolling.

SUBSCRIPTIONS ON THE RISE

THE THREE FACTORS DRIVING MEDIA AND ENTERTAINMENT PROVIDER LOYALTY

The pandemic has fueled subscription rates for media and entertainment providers as consumers have been prompted to spend more time seeking ways to have fun safely at home. These providers are under pressure to keep consumers satisfied to compete in the space and to build long-term relationships with their new customers that will outlast the pandemic. Quality and amount of content often dictate consumers' loyalty to a subscription provider whether consumers are subscribing to streaming services, gaming sites or eLearning platforms, according to a new **study** from Amdocs Media. These factors are most important for video and music streaming services, the report stated.

A third important but often undiscussed factor is the ability to have price or plan options. Such options are particularly important to consumers subscribing to satellite/cable TV, video or music. More than 30 percent of consumers consider having access to competitive price points and plan options to be a factor that influences their loyalty to a subscription media or entertainment provider, according to the study.

NUMBER OF ONLINE VIDEO SUBSCRIPTIONS WORLDWIDE TOPPED 1 BILLION LAST YEAR, REPORT FINDS

Consumers around the globe have continued to seek out ways to entertain themselves remotely during the pandemic, and this trend has been a boon for the online subscription industry. One recent report found that online video subscriptions hit 1.1 billion last year and noted that U.S. consumers were responsible for much of this growth, representing more than 300 million accounts. This spike was largely reflected in the increase in global revenues for digitally distributed services, which rose from $47.2 billion in 2019 to almost $62 billion in 2020. The U.S. market has experienced particularly robust growth, with the total number of online video subscriptions jumping 32 percent year over year.

Consumers' shifts toward digital entertainment subscriptions coincided with a 72 percent dip in box office sales worldwide last year as many theaters closed and patrons avoided crowds during the health crisis. This was partially offset by a 31 percent increase in the global home and entertainment market, illustrating consumers' shift toward subscriptions.

ROUGHLY ONE-THIRD OF AMERICANS ARE TURNING TO SUBSCRIPTION APPS DURING PANDEMIC

Mobile subscription services are also having their moment as consumers — especially those in the U.S. — seek out new ways to stay entertained. A recent survey found that roughly 33 percent of American consumers have signed up for subscription apps from companies like eLearning platform Babbel, video streaming service Netflix and music streaming provider Spotify during the pandemic. Individuals between 35 and 44 years old were particularly inclined to seek out these offerings, with 37 percent of consumers from this demographic saying they signed up for such apps. Their reasons for doing so varied, but 40 percent said these services help them relax and 27 percent said the apps help them feel less lonely. Physical subscriptions have also fared well over the past year, with the report noting that 32 percent of Americans consumers have signed up for services that allow them to receive everything from alcohol to beauty products.

The news may be positive for subscription services providers, but they will still face challenges as the pandemic subsides. Experts warn that some consumers may be inclined to cancel their services unless providers offer tailored experiences, with personalization available in everything from content to payment methods being key to keeping them engaged.

ALMOST ONE IN FIVE UK CONSUMERS TURNING TO PHYSICAL SUBSCRIPTIONS AMID RESTRICTIONS

European countries are also seeing subscriptions soar as consumers confront new pandemic-related restrictions. One study revealed that 17 percent of United Kingdom consumers now have at least one monthly physical subscription service. Twenty-nine percent of these consumers subscribe to food deliveries, 20 percent receive beauty and grooming products and 10 percent receive alcohol shipments. It also found that approximately one in five U.K. consumers subscribe to some form of digital app and that 34 percent of individuals between 16 and 24 years old do so.

Many of these consumers appear to have turned to such services to help them stay positive and entertained as they continue to face restrictions due to the pandemic. Roughly 30 percent of U.K. consumers say receiving monthly subscriptions feels nice, for example, while 22 percent say they appreciate being surprised by what they receive.

MORE NEW ZEALAND CONSUMERS TURNING TO MEAL KIT, GROCERY DELIVERY SUBSCRIPTIONS

Safety amid the pandemic is not consumers' only concern when weighing new subscriptions — some are also prioritizing convenience as they transition away from brick-and-mortar stores. One recent survey polled 13,000 consumers from 12 countries, revealing that four out of five have signed up for subscription services. Many of these consumers are tapping into services that offer meal kits or other grocery delivery options, and such services are steadily gaining appeal among New Zealand consumers. Research estimates that roughly one-third of the nation's consumers have used a meal kit service within the past year, for example, as providers like My Food Bag continue to enter the space.

Food subscription merchants in the country market do face some struggles, however. Experts have noted that the space is becoming crowded with local and regional offerings, causing some services to struggle to stand out and experience high turnover. Offering personalization and smooth payment processes in addition to perks like discounts and promotions could prove vital to their survival.

AUTOMAKER VOLKSWAGEN PLANS TO TEST SUBSCRIPTION SERVICE FOR ID.3 ELECTRIC HATCHBACK

Subscription-based business models are also gaining speed in the automotive market. German automaker Volkswagen recently announced that it is exploring a subscription model for its ID.3 electric hatchback as it searches for new revenue sources made possible by internet-connected electric cars. The company believes that such services could generate annual revenues of more than €3 million ($3.5 million USD) by 2025, and it plans to test the service in six German cities.

The road has been rocky for some car subscription services in recent years, with both Audi and BMW attempting to release such offerings but ultimately scrapping their plans. Experts say some companies have made it work, however, with automaker Volvo using the model to bring value to customers.

ADDRESSING SUBSCRIPTION CHALLENGES

SURVEY SHOWS NEWS ORGANIZATIONS MAKE IT DIFFICULT TO CANCEL SUBSCRIPTIONS ONLINE

Subscription services across various sectors are seeing success, but providers in some industries still have a few wrinkles to iron out to satisfy consumers for the long haul. One recent survey found that just 41 percent of U.S. news publishers "make it easy" for consumers to cancel their services on the web, with many still requiring them to call customer service professionals to do so. Sixty percent of these news organizations have told their customer services representatives to encourage subscribers to maintain their services when they call to cancel.

Research shows that long-term engagement strategies focused on determining why consumers want to cancel can be more useful in preventing abandonment. Just 28

percent of publishers stated that they segment subscribers based on their cancellation risks. Getting more organizations on board with this approach could be the key to helping them identify — and solve — the frictions that prompt at-risk customers to drop out.

A GROWING NUMBER OF SUBSCRIPTION PROVIDERS ARE REDUCING OR ELIMINATING FREE TRIALS

Free trials were once considered a key tool in subscription providers' customer engagement strategies, but recent research shows that these offerings are getting harder to find. Many streaming entertainment companies — including Disney+, HBO Max and Netflix — have **dropped** their free trial promotions, while streaming TV service Sling has restricted access to such offerings. Dan Rayburn, an analyst at research firm Frost & Sullivan, explained that many providers believe eliminating free trials does not discourage customers from signing up. Many companies think that content is the key to attracting and retaining customers, and they thus work to create offerings that will keep them hooked.

Many providers believe that free trials are ineffective in helping them appeal to and retain customers, but some research disputes this assertion. PYMNTS' April 2020 **Subscription Commerce Conversion Index** found that 24 percent of consumers who said they were "very" or "extremely" likely to cancel their services within six months would reconsider if given access to longer free trial periods, for example. This indicates that the strategic use of free trials could be crucial in providers' long-term retention efforts.

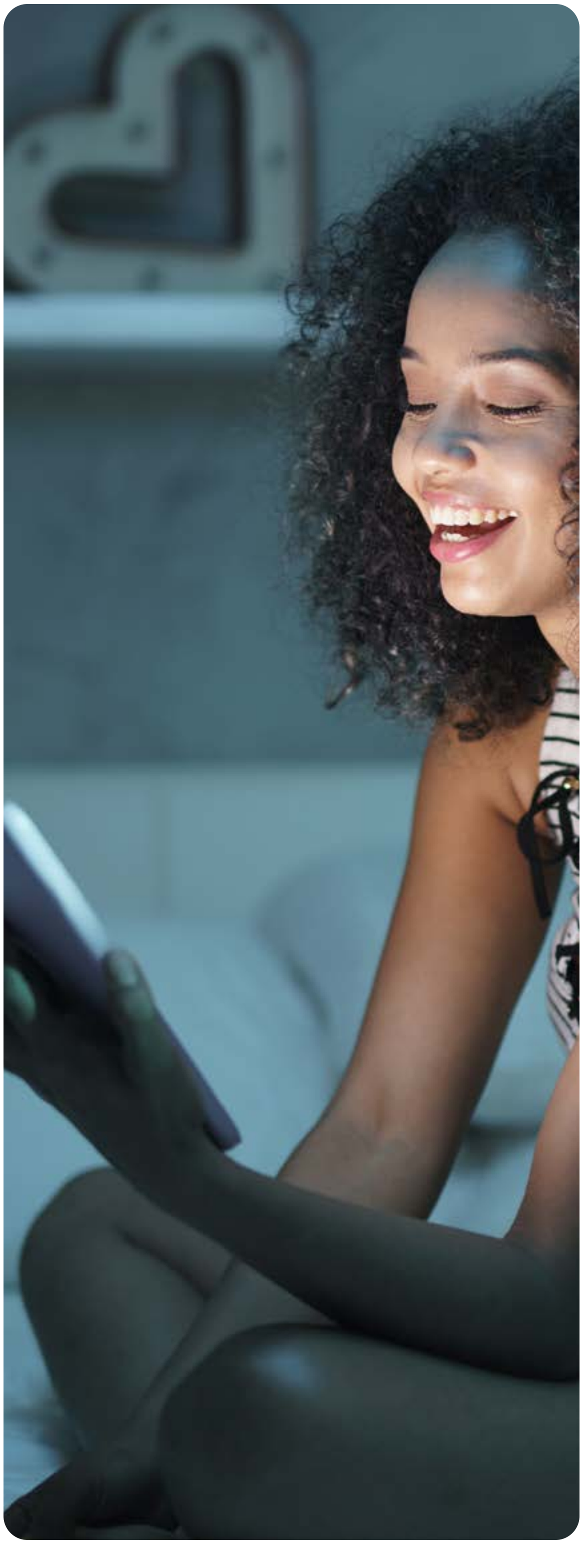
PASSWORD SHARING LINKED TO LOST REVENUES, CUSTOMER FRICTIONS FOR SUBSCRIPTION PROVIDERS

Traditional password networks and antiquated customer authentication tools could be costing subscription companies revenues. One recent **report** found that password sharing and tedious authentication processes are leading to lost profits and customers for websites, with half of U.S. customers between the ages of 18 and 54 stating that they have shared at least one of their accounts' passwords. Forty-one percent said that they routinely share their passcodes — a practice that can dissuade more customers from signing up and paying for their own services.

Password sharing can not only eat into subscription providers' bottom lines but also prevent them from obtaining access to useful data, since multiple consumers with different preferences are using the same account. It can also compromise security as well, especially as companies fielding questions or responding to inquiries from customers do not know with whom they are actually communicating. Some subscription services providers have sought to solve this issue, however. Netflix began restricting the number of devices that can be used simultaneously to stream its content last year, for example, to cut down on password sharing.

Deep Dive

WHY SEAMLESS B2C PAYMENTS ARE CRUCIAL TO LONG-TERM SUBSCRIPTION LOYALTY



Subscription services are getting a boost as consumers seek out ways to experience new products and services as they hunker down at home to stay safe and reduce exposure risks during the pandemic. PYMNTS' **Subscription Commerce Conversion Index** found that nearly three-quarters of U.S. adults — 182 million consumers — subscribed to at least one subscription service last July, up 9 percent from February 2020. Nearly half of these subscribers also said they will likely keep these subscriptions even after the pandemic has eased.

This is no time for subscription service providers to kick up their feet, however. The research revealed that more than 13 percent of subscribers, or about 24 million consumers, said they are "somewhat" or "very" likely to cancel their subscriptions. Merchants will need to work to engage and retain the subscribers they gained during the pandemic by offering seamless user experiences and fast, friction-free payments. The following Deep Dive examines the importance of offering flexible subscription plans and a look at how businesses can avoid obstacles to provide seamless transactions in the subscription economy.

THE EFFECTS OF PAYMENT FAILURES

One recent **study** found 78 percent of respondents have at least one recurring monthly charge on their credit cards and 40 percent have three to five. Consumers want transactions that are simple and frictionless, yet payment failure is widespread across the U.S.

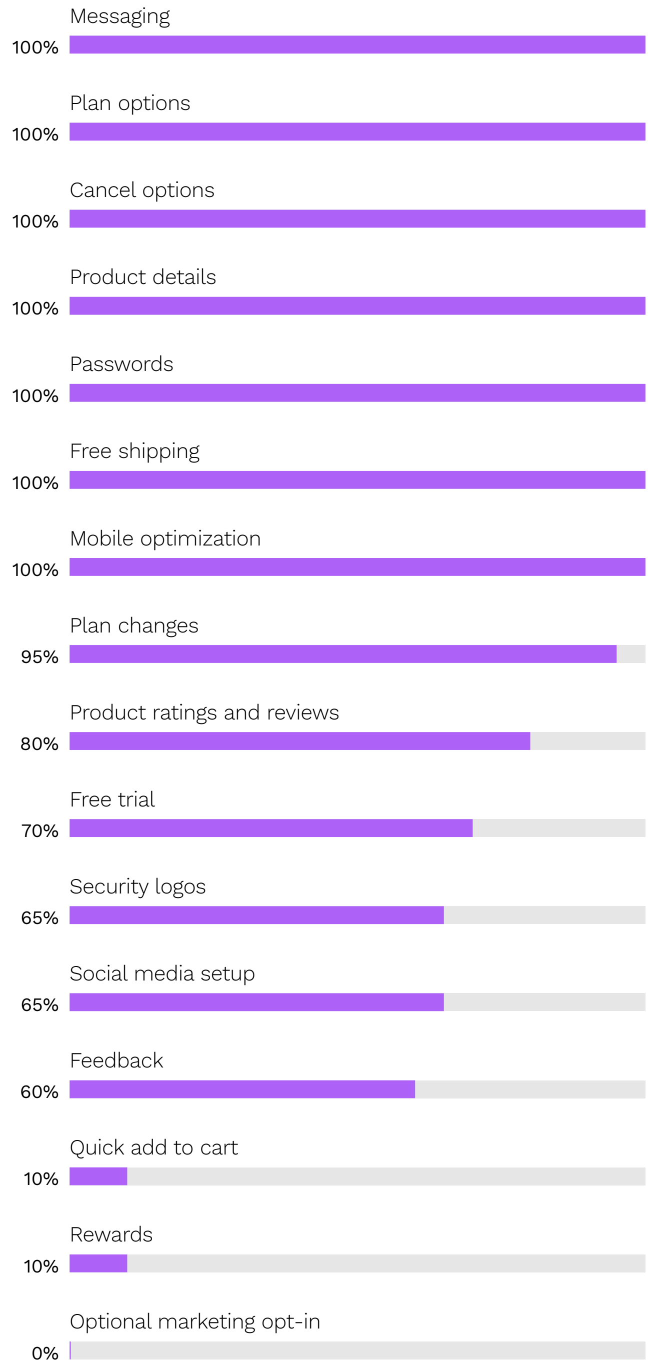
Another online **survey** polling 700 payment executives at business-to-business (B2B) and business-to-consumer (B2C) firms on the state of recurring payments found that more than half of U.S. decision-makers said their payments failed 7 percent of the time over the last 12 months. Such payment failures create bigger roadblocks for merchants, such as customer churn, recovery costs, harmed profitability and bad debt. To prevent failed transactions, solutions leveraging advanced algorithms that do not disrupt the existing billing system, such as **Vindicia Retain**, can be integrated.

Payment frictions and failures can be catastrophic for subscription service providers. Two-thirds of U.S. payments decision-makers report that 11 percent or more of their payment failures resulted in the loss of subscribers over the past year. Losing a single subscriber through passive churn not only represents the loss of one transaction but also forecloses subsequent revenue opportunities that customer would have produced. These payment failures can drive customers to either cancel their subscriptions out of frustration or find that their plans were automatically canceled.

More than half of B2B and B2C decision-makers said the average cost of payment recovery exceeds 11 percent of the payment. Bad debt occurs when credit has been granted to a customer but cannot be collected. More than two-thirds of U.S. B2B merchants said that at least 11 percent of failed payments end in bad debt, and these failures directly impact profits. More than 40 percent of executives

FIGURE 1:

Features provided by 20 top-performing merchants
Share of top-performing merchants providing select features in Q4 2020



Source: PYMNTS.com

said profitability slips when payments fail, ultimately slowing growth. Failed payments therefore strain innovation, lower profits and chill customer goodwill.

REDUCING CHURN RATES

Merchants that offer smooth subscription experiences allow customers to quickly and efficiently customize their service plans and make intelligent choices. PYMNTS' research shows that the major reason customers cancel their plans is their inability to make changes to their subscription services. This proved true for nearly 30 percent of those who subscribed during the pandemic and 15 percent who signed up before the pandemic. It is thus clear that service flexibility can help reduce churn rates.

Merchants are fortunately getting this message loud and clear: Nearly 52 percent now allow subscribers to make changes to their plans and 75 percent provide plan options. This is in contrast to the 48 percent and 73 percent of merchants, respectively, that provided such features in Q3 2020. Research further shows that as much as 95 percent of top-performing merchants provide plan changes and 100 percent offer plan options.

The pandemic has fueled demand for subscription services of all types as consumers spend more time at home. Merchants hoping to cash in by transforming new subscribers into loyal, long-term customers will be best served by offering easier payment options and flexibility. The top subscription services not only simplify onboarding but also offer flexible features that allow customers to customize plans and make the right financial decisions. Merchants unable to meet these demands will risk losing subscribers and may fail to attract new ones.

ABOUT

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