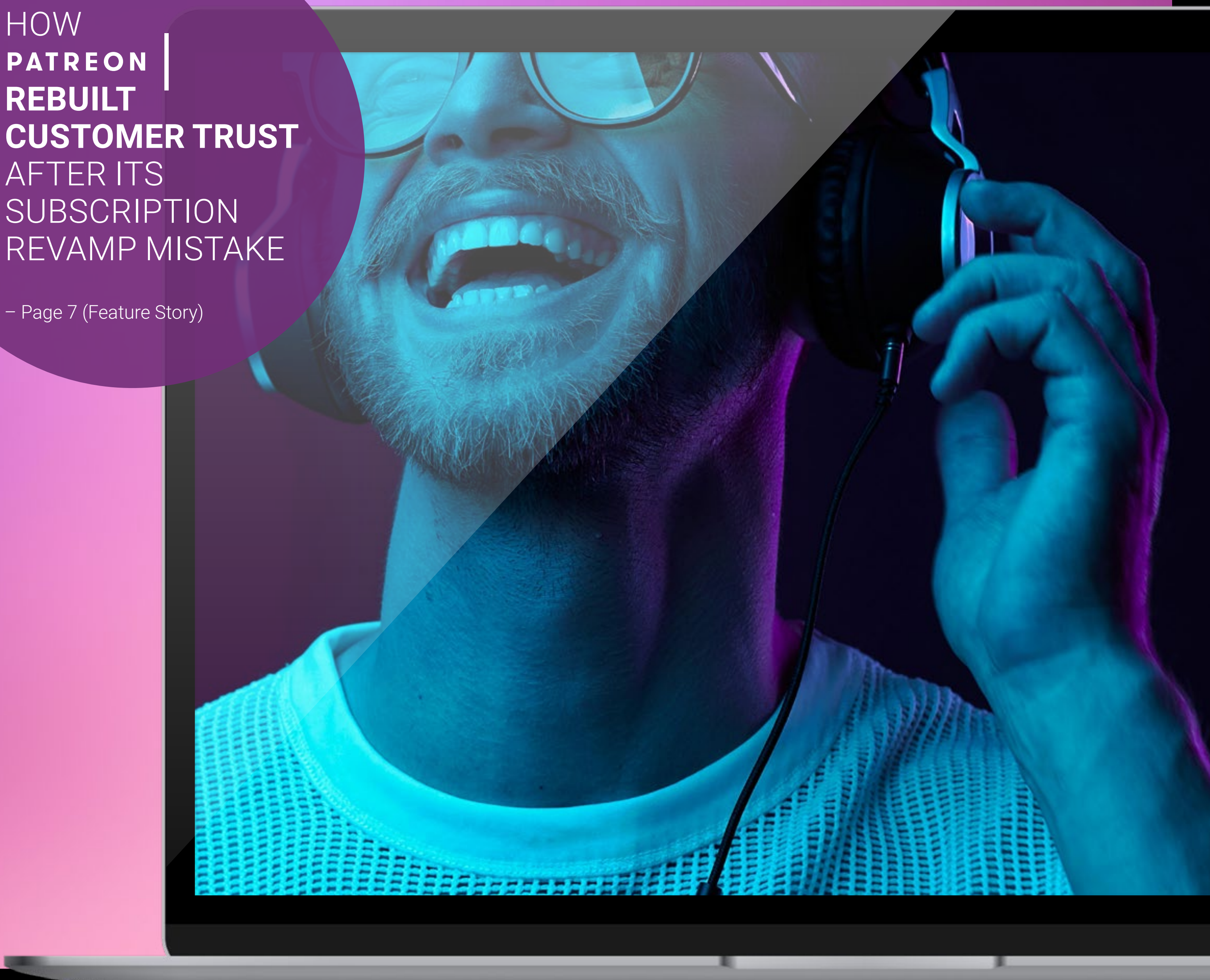
SUBSCRIPTION COMMERCE TRACKER®

FEBRUARY 2020

HOW PATREON REBUILT CUSTOMER TRUST AFTER ITS SUBSCRIPTION REVAMP MISTAKE

– Page 7 (Feature Story)



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ACKNOWLEDGMENT

The Subscription Commerce Tracker® is done in collaboration with Recurly, 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.

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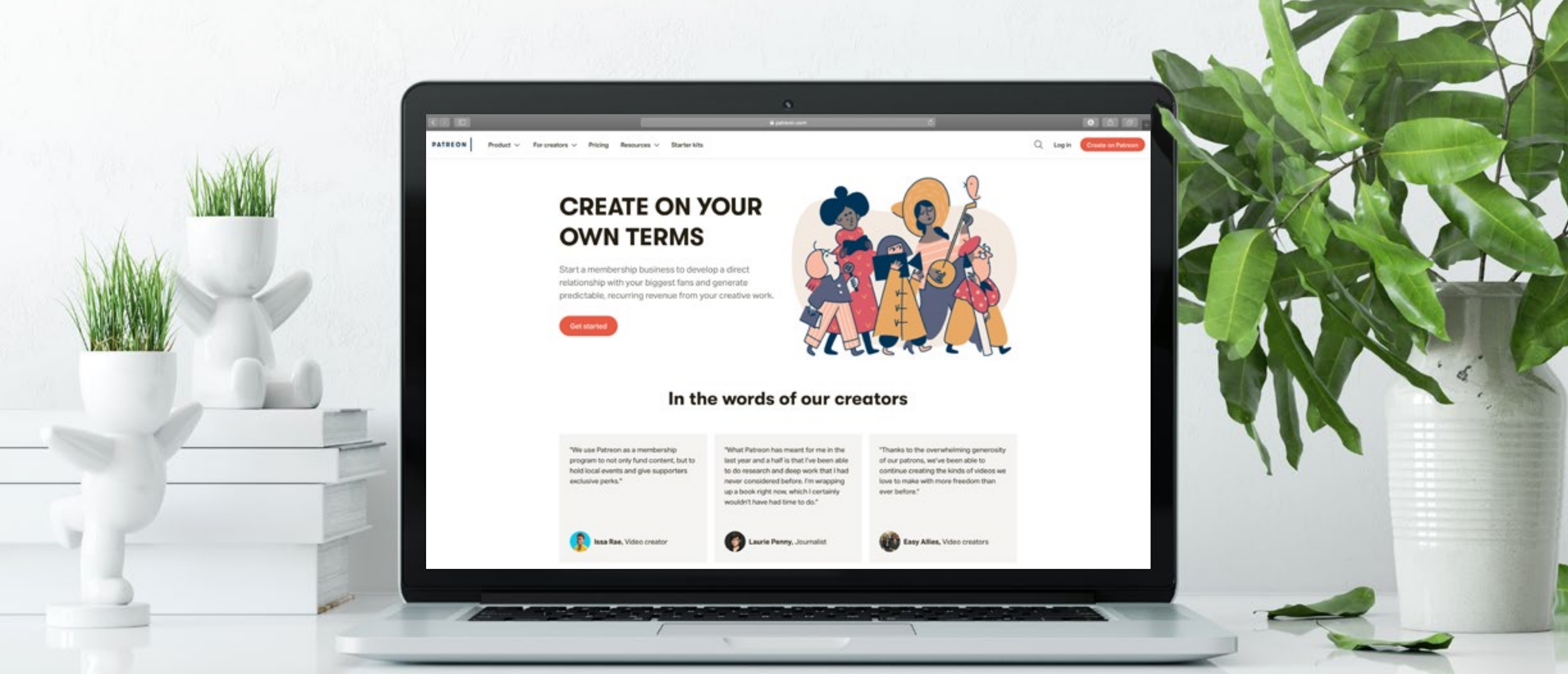
WHAT'S INSIDE

The subscription model has clear financial benefits. Businesses value the recurring funds earned from customers' monthly or yearly payments, and subscriptions often result in higher revenues and profits. Companies from various sectors are thus heavily investing in the technologies and infrastructures necessary to providing enticing subscription services — the last thing these companies want is to lose customers because of stale offerings, after all.

Those investments have taken many forms, including constant innovations and offerings to keep customers coming back. Video streaming services have been pumping out fresh content, for example, airing 532 scripted series in 2019 — up from 409 in 2015. These companies must make sure their users are satisfied with their shows, movies and original content, otherwise they may abandon the platform. The price of the offering has to match its value, too, pushing some firms to consider ad-based models to boost sales revenues, while others use ad-free models to maintain frictionless viewing experiences.

Several industries are refocusing their subscription sales goals, with some seeing an influx of partnerships that are keeping their offerings as exciting, convenient and flexible as possible for customers. Firms are taking on new strategies, revamping existing ones and collaborating to excel in the subscription commerce space.



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Around the subscription commerce space

Streaming video on-demand (SVOD) industry leader Netflix recently released its quarterly results, adding fewer subscribers than expected in Q4 2019. It attributed this lapse to competition from new, lower-priced rivals, such as Disney+. Netflix will not add advertising to its platform to boost revenue, despite seeing continued weakness in the United States market. The company performed better internationally, ending Q4 2019 with 167 million worldwide subscribers.

Magazine and newspaper subscriptions are some of the most popular services, which makes them a favorite among bad actors as well. New York officials recently delivered good news to victims of a magazine scam that Orbital Publishing Group oversaw. Attorney General Letitia James said her office won more than $16 million in restitution and penalties for 68,000 victims and shuttered the scammers' New York and Oregon operations. Digital newspaper and magazine subscriptions have been critical growth engines for many publishers, with the market having 19.5 million customers despite scam risks.

Some companies are realizing that subscriptions may help them forge deeper relationships with loyal fans and new customers. Quick-service restaurants (QSRs) like Arby's and Dairy Queen unveiled subscription boxes for their customers last year, and beverage giant Coca-Cola is jumping on the bandwagon with its Insiders Club offering. The service provides fans with swag, surprises and three sample beverages for $10 a month. Coca-Cola hopes the move will increase brand awareness and enhance customer loyalty.

For more on these stories and other recent subscription headlines, read the Tracker's News and Trends section (p. 12).

Getting to the right subscription plan

Identifying and filling a market need are the first steps toward successful business strategies, but keeping operations growing — and ahead of the pack — means companies must really know their customers and anticipate their needs. The long-term nature of subscriptions requires creating plans that both attract new users and deepen trust with existing ones. This is especially true for artists and other creators who often struggle with financial

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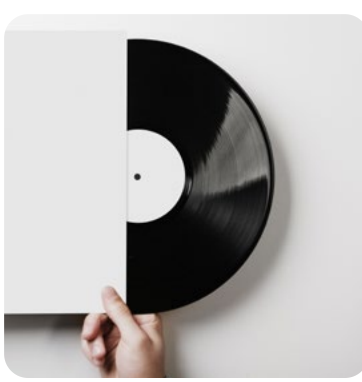
stability and put their faith in platforms that can help them achieve their goals.

For this month's Feature Story (p. 7), Wyatt Jenkins, senior vice president of product at content membership platform Patreon, explains how the firm identified a subscription model that made financial success easier for artists, why it stumbled in its first attempt to revamp its offerings and what management learned from its mistakes.

How the sharing and subscription economies are growing together

Subscriptions and the sharing economy have been around for years, but mobile technology and social media's explosion sent these models into sales and business adoption hyper-growth. Many of the key factors that drive customers to the sharing economy, such as the need for flexibility, convenience and affordability, also draw them to pay for products and services with an automatic monthly or annual subscription plan. This month's Deep Dive (p. 17) highlights the sharing economy's growth as well as the challenges both it and subscription providers must address to continue to succeed.



5 FIVE FAST FACTS

74%

Share of surveyed adults who believe consumers will have **more subscriptions** and own fewer goods in the future

21%

Growth in U.S. subscription app revenue in 2019 among that year's **top 100 subscription apps**

$335B

Estimated market size of **the sharing economy** by 2025

100%

Approximate growth of the subscription eCommerce market over the past five years

$36.7B

Estimated market size of **agile monetization platforms** for recurring revenue subscriptions

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FEATURE STORY

HOW PATREON OVERCAME ITS SUBSCRIPTION STRUGGLES

Careers in music, filmmaking or even YouTube video essays can be daunting and have few financial incentives, causing many young creatives to give up on their dreams so they can make ends meet. Content membership platform Patreon aims to ease these professionals' financial stressors, enabling them to find success as creators. The company's origins date to 2011, when founder Jack Conte uploaded a high-concept music video to YouTube. It turned out to be more trouble than it was worth, however, according to Wyatt Jenkins, senior vice president of product at Patreon.

"[Jack] took all of his savings — I think it was $30,000 or something — and he put it all into this really well-produced video that rebuilt the inside of the Millennium Falcon," Jenkins explained in a recent interview with PYMNTS. "It got 8 or 9 million views, which was a lot back then, and then, at the end of the day, he got a check from YouTube for $161."

A crowdfunding model that allowed artists', musicians' and content creators' fans to subscribe and contribute to the creation of new works seemed to make more sense. Patreon launched in 2013 to fulfill this need, enabling "patrons" to pledge recurring monthly amounts of their choosing to support their favorite artists, many of whom promise additional content for those who donate above a certain threshold. The San Francisco-based company recently announced it has paid out more than $1 billion to creators via 4 million patrons.

"On Patreon, you take home 85 [percent to] 90 percent [of patrons' funds] based on which of our plans you choose," he said. "Any other channel — like Spotify or YouTube or Facebook — you're getting fractions of a penny."

> They would rather we just give them the fee and the option to give it to their fans, **and then they can decide how that financial interaction looks.**

The platform has evolved from a marketplace connecting fans and creators to a software-as-a-service (SaaS) platform that enables the latter to offer patrons different pricing tiers. The journey has been far from smooth, though. PYMNTS caught up with Jenkins to discuss Patreon's current and former subscription models' challenges and successes, as well as what might be in the works for the future.

Not all smooth sailing

Patreon's first subscription model revamp occurred in 2017, when developers released a processing fee structure update. Fees would no longer be deducted from creators' revenues and would instead be passed on to patrons as 2.9 percent service fees plus an additional $0.35 per pledge.

"The decision was made that patrons are used to paying … extra fees when they do eCommerce transactions online, so [we rolled] out a fee that goes to all patrons," Jenkins explained. "I think that might be the top one or two disasters at Patreon."

The backlash was swift and severe, with creators fearing that the additional charge would damage their relationships with supporters, possibly to the point that their incomes would decline from waning patron numbers.

"Creators said, 'Hey, wait a second, these are my fans,'" he said. "'If there's going to be a fee, I'll choose whether there's going to be a fee.' They would rather we just give them the fee and the option to give it to their fans, and then they can decide how that financial interaction looks."

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It's our job to respect the relationship between creators and their fans. We help [the former] acquire fans and retain fans, but we don't get in between [them and their] fans.

The structure change was quickly rolled back, but it did teach Patreon about the nature of its relationships with creators and patrons, and how the latter two interact. Its most recent subscription update took this lesson to heart.

Learning from the past

Patreon unveiled its new tier-based subscription model — which includes Patreon Lite, Patreon Pro and Patreon Premium — last year and designed it with the 2017 episode in mind.

"It's our job to respect the relationship between creators and their fans," Jenkins said. "We help [the former] acquire fans and retain fans, but we don't get in between [them and their] fans. That was a pretty important lesson for us, and you can see a lot of that in our rollouts since."

Patreon Lite, the lowest tier, charges a 5 percent fee and gives creators pages that patrons can view. Patreon Pro has an 8 percent fee and offers a landing page, archives that fans can peruse and messaging capabilities for creators and patrons. The highest tier, Patreon Premium, is meant for full-time creative professionals and charges a 12 percent fee. It includes all features from the previous tiers as well as merchandise, business plan assistance, exclusive creator events and customer analytics.

Creator-patron partnerships are crucial to Patreon's continued success, but they rely on trust. Patrons must be assured that creators will use their funding for additional projects, and that transactions will be protected from rising fraud threats impacting platforms worldwide.

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Cleaning out money launderers

Patreon has seen its share of bad actors, many of whom use the platform for money laundering. They set up creator pages and add a slew of illegitimate patrons, who then pay the false creator with stolen credit card data. Filtering fraudsters is a constant challenge, but the company is still small enough that manual verification does the job.

“We’re at the scale with hundreds of thousands of creators, [so] we can mostly do this with hand-to-hand combat,” said Jenkins. “We don’t need to be algorithmically driven [like] YouTube, where you’ve got to deal with a quarter of humanity.”

Patreon implements additional security measures at the point of payout, requesting more stringent proof of identity before releasing creators’ incomes. This helps the company with taxes, and Jenkins predicts further back-end innovations will help creators use Patreon to make their creative outlets their full-time professions.

“We’ll help people with taxes, we’ll help people with healthcare, we’ll help people with loans against future earnings,” he said. “We can do this because we can predict, with very little volatility, what creators will [earn] for a good three to five years based on the recurring nature of their memberships.”

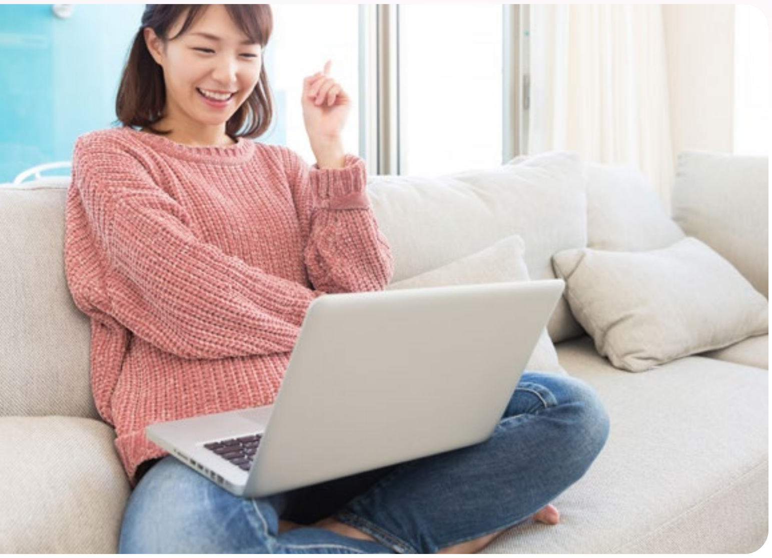
This lack of volatility is what drives many businesses to explore subscription models in the first place. Patreon’s growth in the subscription space, including its stumbles and lessons learned, could serve as an excellent example for future industry players.

NEWS AND TRENDS

ACROSS THE SVOD SPACE

Netflix continues to reject ads amid slowing US growth

Video streaming competition is escalating as NBC Universal launches Peacock and WarnerMedia unveils HBO Max, among other new offerings, but market leader Netflix is not feeling the heat. CEO Reed Hastings announced during a Q4 2019 earnings call that the company will continue to remain ad-free, even as rivals such as Disney+ see impressive gains from related revenue. He also noted it would not make financial sense for Netflix to challenge advertising giants like Amazon, Facebook and Google, given their customer data advantages.



Some Wall Street analysts estimated that Netflix could earn an additional $1 billion or more each year, however, if it introduced an ad-supported tier.

Other reports predict that the company's slow growth will result in 4 million lost subscribers in the U.S. this year, despite the fact that the company reportedly added 8.8 million net subscribers in Q4 2019 — well ahead of its forecasted 7.6 million. Hastings noted that Netflix's business model is simple, focusing on "streaming and customer pleasure" rather than "exploiting users" to distribute targeted advertising.

Pilot expands Netflix in India

International market growth was largely responsible for Netflix's Q4 2019 increase in subscribers. The steaming giant has been expanding its user base in India, which has the second-largest number of internet users in the world. Netflix launched a pilot in the country, offering discounted, long-term subscriptions to new users, who will be able to choose from three-, six- and 12-month plans.

Netflix has more than 100 million overseas subscribers, and the company will dedicate Rs 3,000 crore ($420 million USD) to new programming in India this year. Competition is intense, however, as Amazon Prime Video and other rivals already offer similar plans in the country. Analysts estimate India's video streaming market will reach $5 billion by 2023.

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Disney+ reaches $100B valuation

Analysts may be lowering their Netflix forecasts, but some seem to be more bullish about competitor Disney+. Barclays estimates that Disney's streaming business — which also includes Hulu and ESPN+ — is valued at approximately $108 billion. Disney+ gained 10 million subscribers on its first day of service in November 2019, some think it will hit 25 million in its first quarter and Disney believes the service will grow to between 60 million and 90 million global subscribers by the end of fiscal year 2024. The company is looking to accelerate the platform's launch date in Europe, making the service available in Austria, France, Ireland, Italy, Spain, Switzerland and the United Kingdom on March 24.


Image source: Disney

Streaming providers set aggressive subscriber acquisition goals

Customers are not yet exhausted with content streaming options, and providers' subscriber acquisition goals are keeping up with growing demands. Recent reports suggest that providers are set to spend heavily on new content this year to keep current customers entertained and attract new ones. More than 532 scripted series aired in 2019 — up from 409 in 2015 — and platforms are working hard to give subscribers quality material that will keep them loyal.

AT&T is hoping HBO Max will reach 50 million domestic and 75 million to 90 million global subscriptions by 2025, while ViacomCBS expects CBS All Access and Showtime to reach a combined 25 million subscriptions by 2022. David Zaslav, CEO of Discovery, Inc., believes that only two or three of the main streaming services will last, and that the number of original shows will decline as such investments are difficult to maintain.

Plex to add subscription channels

Media streaming service Plex announced last month that it will launch an ad-based streaming service in 200 countries. The platform will feature thousands of movies and shows from studios including Legendary, Lionsgate, MGM and Warner Bros., and compete against services like Crackle, Roku Channel and Tubi, which offer content streaming without subscriptions. Plex users will be able to

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stream content outside the U.S., making it the largest ad-supported video service in terms of reach.

The company serves approximately 15 million households, but the share of users who pay for its Plex Plus subscription service is much smaller. Plex hopes its new offering — which will include subscription video streaming, a rental and purchase marketplace and deep linking to other platforms for programs it cannot host — will promote usership and revenue growth.

MUSIC AND RETAIL SUBSCRIPTIONS

Amazon surpasses 55M music streaming customers

Video streaming services are not the only companies seeing customer growth. eCommerce giant Amazon is adding more subscribers to its Amazon Music service, despite heavy competition in the space. The firm recently announced that the platform exceeded 55 million global customers across its free and paid tiers, touting the number as an "incredible milestone" that included growth of more than 50 percent in its top tier, Amazon Music Unlimited, which costs $9.99 per month. Amazon Music still trails rival music streaming platform Spotify, which had 113 million paid subscribers as of September 2019, and technology firm Apple's Apple Music, which boasted more than 60 million users — including free trial participants — in June that same year.

US states crack down on publication subscription scams

Acquisition numbers are not the only subscription elements on the rise — scams are also seeing growth, with those impacting newspaper and magazine subscriptions among the most pervasive. New York officials recently shuttered a significant operation out of New York and Oregon, with Attorney General Letitia James announcing that her office won more than $16 million in restitution and penalties for 68,000 New Yorkers. She accused Orbital Publishing Group of mailing customers across the country illegal and misleading magazine and newspaper subscriptions — supposedly from well-known companies such as Consumer Reports, Entertainment Weekly and The New York Times — over the course of approximately three years. The scammers stated they offered low rates, but they were actually charging more than double that of legitimate companies, with Orbital pocketing the difference.

Better Business Bureau (BBB) branches in Colorado and Wyoming have warned about such scams, including a 2018 effort in which consumers received false solicitations for subscription renewals as well as fraudulent door-to-door magazine sales. More than 1,100 magazine sales-related complaints were filed that year, according to Katherine

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Hutt, chief communications officer at the International Association of Better Business Bureaus, and the Federal Trade Commission (FTC) reported that 6,309 fraud-related book and magazine complaints were filed with the Consumer Sentinel Network.

Coca-Cola turns to subscriptions to boost its brand

Beverage seller Coca-Cola may not be fighting fraud, but it is combatting reports that its brand is losing some of its luster. The company is looking to freshen its image with the launch of an Insiders Club subscription box, which features branded gear, surprise gifts and three sample beverages for $10 per month. Other firms have previously made similar moves, such as Arby's January 2019 launch of the Arby's of the Month box and Dairy Queen's Box of Happy, which debuted in May that same year.

The approach appears to be working for Coca-Cola, which "completely sold out for the early 2020 Insiders Club," according to its website. The company is encouraging fans to join a wait list, suggesting it may continue the service after its six-month pilot.

DRIVING SUBSCRIPTION ADOPTION

Subscription clothing remains in vogue

Consumers' desires for friction-free shopping experiences and their propensity to rent their wardrobes have boosted clothing subscription models, which entered the new year with plenty of momentum. Clothing rental platform Rent the Runway teamed up with Marriott's W Hotels brand in December 2019 to offer the latter's guests clothing rental services. The service costs $69 and allows travelers to select clothing for their trips, which they then leave in their rooms when they check out.

H&M announced related news last month, stating that its COS brand is collaborating with Chinese

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subscription rental platform YCloset to test clothing rentals. American Eagle Outfitters, Banana Republic and Urban Outfitters are trying the clothing rental subscription model on for size as well, announcing new offerings and partnerships to lend consumers clothing. These efforts may drive the global online clothing rental market to $1.9 billion by 2023, according to Allied Market Research, which valued the industry at approximately $1 billion in 2017.

Toyota drives subscription model into Europe

Car companies are also embracing subscriptions to cater to customers seeking convenience and variety. More drivers are looking to rent or share vehicles, as opposed to owning them, and luxury automakers Cadillac and Mercedes-Benz are meeting those needs with subscription offerings. These platforms are contributing to the 71 percent compound annual growth rate (CAGR) analysts expect of the global automotive subscription market through 2022.

Automaker Toyota is also enhancing its carsharing services with its KINTO initiative, which expands the company's European offerings into ridesharing, carpooling and subscription-based leasing. The rollout includes four programs, Flex, Join, One and Share. KINTO Share allows consumers to book cars by the hour or for a day through a mobile app, KINTO Flex enables vehicle rentals through an ongoing subscription, KINTO Join helps customers find carpool partners and KINTO One offers insurance, car payments and maintenance in a comprehensive bundle. Toyota is also considering launching a ridehailing app.

Subscription app revenue exceeds $4.6B, study finds

Explosive mobile device usage has supercharged growth among businesses offering everything from food to fashion to sharing services. Related revenue is keeping pace, according to a recent report, with the top 100 U.S. subscription apps' revenues passing $4.6 billion in 2019 — a 21 percent increase from $3.8 billion a year earlier. Online dating app Tinder was the highest grossing, accruing 10 percent of that revenue through its recurring subscription offerings. Pandora, YouTube, HBO Now, Bumble, Hulu, Google One, LinkedIn, YouTube Music and ESPN, in that order, rounded out the top 10.

Subscription revenue from these apps accounted for 19 percent of U.S. consumers' $24 billion total spend in 2019, the report found, a trend that is projected to continue. The top 10-ranked subscription apps grew by 10 percent last year, with the rest seeing 35 percent growth.

Success begins with the right (subscription) plan

The latest Subscription Commerce Conversion Index, a PYMNTS and Recurly collaboration, found that the top three features companies should keep in mind when planning their next subscription offerings were options, free shipping and free trials. The index considered how smart subscription innovators were using features across business segments to differentiate their offerings from the competition. The top 20 merchants — a list that included Amazon Music — offered multiple price options and free shipping. Three-quarters enticed customers with free trials, and only 10 percent offered rewards for making purchases or creating accounts.

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DEEPDIVE:

Optimizing Subscriptions In The Sharing Economy

The sharing economy has rapidly expanded in the U.S., but even the most popular innovations fall out of favor if they do not keep customers satisfied. The market's players have taken this to heart, tapping subscription-based strategies to solidify customer loyalty, boost revenues and maintain upward trajectory.

The number of U.S. adults participating in the sharing economy is expected to grow to 86.5 million next year — up from 44.8 million in 2016 — driving revenue in the space to $335 billion by 2025. Companies both in and out of the sharing economy are investing in enterprise system upgrades, which will enable subscription model adoption and boost the agile monetization platforms market's value from $8.5 billion in 2016 to $36.75 billion by the end of this year. Subscription eCommerce has grown more than 100 percent per year since 2016, largely because of consumer and business demand, leaving many companies wondering if combining the two approaches will create positive impacts.

This month's Deep Dive explores how consumer demand has impacted subscription-based sharing economy services, as well as the operational, financial and regulatory challenges both spaces must confront as they expand.

Demand for convenience, flexibility driving growth

Subscription platforms and the sharing economy are driven by users' demands for affordability, convenience, flexibility and variety. Both markets leverage the internet and mobile technology to gain footholds in various industries while also providing access to products or services consumers would increasingly rather rent than own.

Those in the sharing economy provide goods or services to users around the globe, many of whom no longer wish to assume long-term financial burdens, such as car loans. These consumers would rather use apps to hail Uber or Lyft rides, for example. This is especially true of millennial consumers, who have travel-light, consume-less mentalities and have billions of dollars in spending power.

Three different marketplace types — person-to-person (P2P), business-to-business (B2B) and business-to-consumer (B2C) — provide sharing

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economy opportunities to specific audiences. P2P providers such as Airbnb do not own the assets on their platforms, instead allowing owners to list their rentable goods. B2C marketplaces, such as Rent the Runway and Zipcar, own their resources and allow users to rent them for predetermined time frames. B2B platforms help companies rent necessary gear — a construction firm could rent tractors from platforms such as Yardclub, for example.

These marketplaces grant users access to what they need, giving them convenience, flexibility and access to new opportunities. A small company working to complete projects on time and grow its business might not have the finances to purchase its own equipment, making renting a budgetary godsend. A woman looking for an outfit for a company banquet might not want — or be able — to buy an expensive garment for the occasion, increasing the appeal of clothing rental options.

An end to ownership

A recent survey found that more than 80 percent of U.S. adults who are familiar with the sharing economy say it makes everyday costs more affordable, while 83 percent noted its convenience. One of the sharing economy's founding principles is that it encourages sustainability, with 76 percent of adults believing that sharing is better for the environment. Rented items can be used multiple times by many different people before being discarded — a road bike gathering dust in a garage can assist a consumer while giving its owner a new income source. These same factors also make subscriptions appealing, giving consumers access to otherwise pricey products or services for lower monthly or annual fees.

Subscriptions are now key to the sharing economy, where some retailers have launched such offerings to supplement their operations. PYMNTS dubbed 2019 the year of clothing subscriptions after American Eagle Outfitters, Banana Republic, Urban Outfitters and other brands announced packages or partnerships for clothing rentals. The space is projected to make up 75 percent of direct-to-consumer (DTC) brands by 2023.

That growth is impacting other retail spaces, as well. Furniture retailer IKEA announced it would consider a subscription through which items like desks and sofas could be reused as many times as possible before being recycled, citing a push for increased sustainability. Cadillac and Toyota are similarly offering rental and carsharing subscription options, contributing to a 71 percent CAGR for the global automotive subscription market through 2022. Subscribers pay flat monthly fees for access to fleets of cars from the automakers.

This potential end to ownership bodes well for subscription growth, too. One report found that 71 percent of adults in 12 countries use some kind of subscription service, and that 74 percent believe consumers will look to subscribe rather than own in the future. Companies interested in additional funds beyond rental fees are attracted to the subscription's recurring revenue streams, which would allow them to better manage their budgets, grow their businesses and plan ahead. Shifting to such a model can pay off big for businesses, with firms in the Asia-Pacific, Europe and North America seeing subscription-based sales grow by more than 300 percent over the last seven years, according to recent research. This increase represents a CAGR of 18 percent that can be felt in almost every industry.

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Overcoming growth speed bumps

Sharing economy and subscription businesses are contending with financial, operational and even regulatory challenges that could halt growth, however. Traditional taxi drivers have fought carsharing services, for example, sometimes leading to violent strikes around the globe. Damaged products or misleading advertising could hurt the trust that underpins the sharing economy, making consumers feel unsafe. These concerns are not unfounded, either, with Uber having dealt with sexual assaults, murders and fatal crashes that occurred through its platform, for example. Each negative story or interaction can hinder customers' satisfaction and prevent new users from onboarding.

Sharing companies are also tackling regulatory and legal uncertainties as cities and states look to better regulate their operations, ensuring quality standards and determining if firms are fit to operate. Overcoming such issues could result in a boon for those that employ subscription models, however, pushing many to spend millions on innovative payment technologies like artificial intelligence (AI) and machine learning (ML) to fight sharp upticks in fraud, better tailor their users' experiences and prevent customer churn.

Sharing economy and subscription-based business models have demographics on their side, as well. Millennials and members Generation X and Generation Z are customers of both, and the latter is equipped with an annual spending power of $44 billion. Both spaces already appear to be enjoying a fiscally symbiotic relationship, though — one that promises a smoother ride to even greater growth.

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We are interested in your feedback on this report and where we take it over time. Please send us your thoughts, comments or questions to SCCI@pymnts.com.

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