SUBSCRIPTION COMMERCE TRACKER

JULY 2019

KEEPING SUBSCRIPTION BOXES **SECURE** FROM STEM TO STERN

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Recurly

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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.

WHAT'S INSIDE

The subscription eCommerce market is growing at an astonishing rate, having increased by more than 300 percent over the past seven years. United States consumers are subscribed to an average of three different services, up from 2.4 just five years ago, and 34 percent say they will use more offerings like these within the next two years.

Churn rate is a constant worry for subscription businesses. Customers may voluntarily end their subscriptions due to dissatisfaction with them, or may experience payment issues that result in their accounts closing down. Recent research found that subscription companies have an overall churn rate of 5.6 percent, though this varies greatly depending on the industry. Media streaming services like Netflix, Spotify and Hulu have churn rates around 5.2 percent, while those for box-of-the-month subscriptions are as high as 10.5 percent. Higher-priced services typically experience lower churn rates, as customers are apt to carefully account for these costs.

New services are entering the subscription market every day despite the threat of turnover. Ridesharing giant Uber is currently testing an all-inclusive and discounted access subscription model, while web browser Firefox is developing a news subscription service. Many companies are likely to want a piece of the pie as long as the subscription industry's considerable growth continues.

Subscription developments around the world

Netflix reported a net loss of 126,000 U.S. subscribers last quarter, marking the first time since 2011 that the company has lost more American subscribers than it gained. The drop is likely due to increased competition from new streaming services from WarnerMedia, NBC Universal and Disney. The number of Netflix subscribers in the U.S. now totals approximately 60 million.

Amazon Music has fared much better, with membership growing by 70 percent over the past year, according to a report by MIDiA Research and *The Financial Times*. This growth exceeded that of Spotify and Apple Music, its more established competitors, and is largely due to the popularity of Echo and Alexa devices, which default to playing music from Amazon.

Music and movie streaming are well-entrenched in the subscription commerce ecosystem, but video game streaming is still gaining momentum. The latest entry is Google Stadia, a cloud gaming service announced prior to the Electronic Entertainment Expo (E3) last month. The console is expected to retail for $129.99 when it launches in November, and Google will also offer users a subscription plan for $9.99 a month that comes with free games, exclusive titles and the ability to stream at 4K resolution and 60 frames per second.

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

KiwiCo's collaborative approach to payments security

There are approximately 200 children's subscription services in the U.S., offering products ranging from books to toys to clothes. Although they account for only a small fraction of the overall subscription market compared to more adult-focused services, they still face the same vulnerabilities and security issues, such as account takeovers (ATOs) and card-and-wallet tests. Bill Onderdonk, chief operating officer at educational children's subscription box provider KiwiCo, states that the company takes a collaborative approach to security. For this month's Feature Story (p. 6), PYMNTS spoke with Onderdonk about KiwiCo's subscription model and how the business works to box out fraudsters.

Deep Dive: How online gaming competes in a global subscription market

The video gaming industry was one of the first to experiment with subscription models, with early online games like "EverQuest" and "World of Warcraft" charging monthly fees to maintain their servers. Such games are starting to feel the squeeze of competition from mobile, console and free-to-play games that earn revenue through microtransactions, however, and video game subscriptions are changing as more offerings move online. This month's Deep Dive (p. 14) explores the how online games are adapting to the expanding subscription marketplace, and the measures companies must take to remain competitive.

FIVE FAST FACTS

70%

Portion of U.S. consumers subscribed to at least one streaming service

70.7%

Portion of digital media consumers who plan to cancel their subscriptions within a year after just one month of service

8%

Share of streaming service consumers who plan to cancel their subscriptions within one year

30%

Portion of U.S. consumers who are subscribed to a gaming service

22.8%

Share of consumers who cite affordability as their reason for planning to end their subscriptions within a year

FEATURE STORY

Keeping Subscription Boxes

SECURE

FROM STEM TO STERN

There are approximately 200 different children's subscription services in the U.S. Stitch Fix Kids, for example, sends out a selection of kids' clothing each month, while GiftLit focuses on curated children's books.

Such boxes represent a small segment of the broader subscription market, but they face the same challenges, including fraud attempts like card-and-wallet tests and ATOs. Box-of-the-month services constantly struggle to secure their payment processes and remain a step ahead of bad actors.

KiwiCo, a monthly science, technology, engineering, art and math (STEAM) subscription box for children, is improving its security practices by partnering with third-party providers. Bill Onderdonk, the company's chief operations officer, recently spoke with PYMNTS about KiwiCo's subscription model and how it keeps customers' data safe from bad actors.

Generating data through product tests and surveys

KiwiCo was founded in 2011 and offers seven different subscription boxes focused on different age groups or interests. The Tadpole Crate is geared toward children ages 3 and younger, while the Tinker

"We look at subscription as **a format, not a business,** per se. As a business model, the advantages of subscriptions in terms of creating a **recurring revenue stream** are pretty obvious. But there [are] some consumers that are going to appreciate the opportunity to buy a subscription format, and there [are] other consumers that are going to want to buy in a nonsubscription format."

Bill Onderdonk, chief operating officer at KiwiCo

and Doodle Crates are designed for those ages 9 to 16. The boxes are available a la carte, but the majority of KiwiCo's business comes from monthly subscriptions.

"As a business model, the advantages of subscriptions in terms of creating a recurring revenue stream are pretty obvious," Onderdonk explained. "[But we also] think it's a better experience. [Kids are] getting the continuity of projects that really build on each other and help [them] develop skills."

Children test each box before it is released and provide feedback to the company's designers, with further critiques coming from surveys sent to customers.

"It creates a nice incoming data stream for us on what's working and what's not working," Onderdonk said. "That lets us tailor future product development, whether that's incorporating that feedback into brand-new products or improving existing products."

Keeping fraudsters out of the box

KiwiCo partnered with a number of third-party payments providers to protect against bad actors, ultimately settling on the Netherlands-based global payments platform Adyen.

"We did a bunch of [requests for proposals] and felt that they offered the best combination of services, capabilities and price," Onderdonk said. "They're built with the international transaction footprint in mind and they have a more modern [application programming interface] and integration framework, so it's a bit easier to work with than the previous providers we were using."

Adyen allowed KiwiCo to develop tools that flag and analyze transactions, including a risk assessment profile that assigns scores to orders based on how likely they are to be fraudulent. Transactions that are deemed too risky are either automatically denied or passed to human associates for further inspection.

KiwiCo also leverages a system that prevents card-and-wallet tests, in which fraudsters rapidly try the validity of hundreds of stolen credit details. Mail-order subscription businesses are tempting targets for these tests as they quickly process credit cards and addresses and can immediately inform fraudsters if their stolen data is genuine.

"They're looking for ways to [confirm] that what they have is a valid card ZIP code or card address match that they can then use somewhere else," Onderdonk explained. "They're not intending to buy a good, receive the good and resell it."

KiwiCo has velocity checks in place that prevent scenarios in which one person is running tens or hundreds of transactions.

"They're just sort of pinging our system and trying to see if they can find a valid card or card address match," he said.

Online businesses often struggle balancing security with seamless customer experiences, as well.

"The two lenses for us, in general, are managing your payment risk and your approval rates," Onderdonk said. "You can have zero risk and low approval rates or you can have high risk and 100 percent approval rates, but the business judgment call is also really just where to dial that in."

Credit card chargebacks are key monitoring points that determine how effective KiwiCo's security measures are, he explained. The company can use them to define acceptable risk levels and adjust security measures in ways that do not alienate customers. The only customer-facing security measure KiwiCo currently utilizes is passwords.

"Fortunately, given the price point … of our product, we don't see a lot of fraud attempts," Onderdonk said. "So, we've been comfortable where we have currently set the level of risk."

A product-first approach in a competitive market

Some estimates state that the subscription box space has grown by almost 800 percent over the past five years, and KiwiCo is well aware of the fierce competition within the market. The subscription model is only a means to an end for the company, which puts the product first.

"I would be bullish on subscription in general for products where it makes sense," Onderdonk said. "First and foremost, it's about the product being awesome. I don't think the benefits of a subscription as a format such as convenience or surprise are going to overcome a product experience that is subpar. However, if the product pays off, I think the benefits of a subscription can be real value-add for the customer."

Onderdonk's theory will surely be put to the test as the subscription economy continues to grow.

NEWS AND TRENDS

Subscription trends

Americans waste hundreds on unused streaming subscriptions

A GOBankingRates study of 1,000 Americans found that many waste hundreds of dollars each year on unused subscription streaming services. Half of those surveyed pay for some sort of entertainment subscription — Netflix being the most popular, followed by Amazon Prime and Hulu — but 4 percent never use the services for which they pay. Those with unused services paid for an average of 1.65 subscriptions and wasted $347.81 per year.

Millennials were most likely to pay for unused subscriptions, with 7 percent of those between the ages of 25 and 34 not utilizing their services. This number was just 2 percent for consumers aged 65 and older. Women were slightly likelier to not use their services than men, with a difference of half a percentage point.

Netflix reports net decrease in American subscribers

While some Americans are losing money on subscriptions they do not use, others are canceling their subscriptions outright. Netflix reported earlier this month that it experienced a net loss of 126,000 subscribers in the U.S. last quarter, bringing its total domestic subscribers to 60 million and marking the first time since 2011 that it lost more American customers than it gained. Analysts had predicted the streaming service would see a net gain of 352,000 domestic subscribers. Netflix's stock sank 10.3 percent the day after the news broke, and the company is reportedly investing more in foreign subscribers and in-house productions to counter the loss of American subscribers.

The loss is due to a number of factors, the most significant being increased competition from companies like WarnerMedia, NBC Universal and Disney, which have all announced their own streaming services. These companies are planning to remove a number of heavily watched shows and movies from Netflix's selection, most notably "Friends," "The Office" and Disney's entire catalog, including the Star Wars franchise and the Marvel Cinematic Universe.

Netflix to offer cheaper subscriptions in India

Netflix is courting the Indian market by offering the country's subscribers a new, low-price option. The solution restricts viewing to a single device, provides streaming in only 480p and was tested in several Asian markets at the price of $4 USD per month. Netflix has not yet announced the official pricing for the Indian offering.

India is a growing market for streaming services, but implementation is difficult due to the country's per capita gross domestic product (GDP) of less

than $2,000 USD. Spotify entered the market earlier this year, offering its paid service for Rs 119 ($1.60 USD) per month. Disney-owned streaming service Hotstar offers approximately 80 percent of its content to Indian viewers for free and has amassed more than 300 million monthly active customers — an impressive sum given that India has just 500 million internet users.

Amazon Music is growing faster than established competitors

A MIDiA Research and *Financial Times* report found that Amazon Music membership grew by 70 percent over the past year — a rate exceeding that of more entrenched competitors Spotify and Apple Music. While this brings the service's total number of subscribers to an estimated 32 million, it is still coming up short compared to Apple Music's 60 million and Spotify's 100 million. The latter companies grew by 50 percent and 32 percent year-over-year (YoY), respectively.

The report noted that Amazon Music's growth has largely been driven by the popularity of Echo and Alexa devices, as both default to playing music from Amazon Music. These products accounted for approximately two-thirds of all smart speaker sales in the U.S. last year. The research also found that Amazon Music users are slightly older than those who use Spotify: Approximately 14 percent of the former's listeners were over the age of 55, compared to 4 percent for the latter.

Video game subscriptions

Google announces new console with subscription plan

Technology giant Google unveiled its Stadia gaming console just before June's E3 event. Stadia streams games similarly to how Netflix streams video, and is an upgrade from traditional platforms like Sony's PlayStation or personal computers (PCs), which load games from physical media or download them to their hard drives. The console is expected to retail for $129.99 when it launches in November, and Google will offer a subscription plan for $9.99 a month providing users with free games, exclusive titles and the ability to stream at 4K resolution and 60 frames per second.

Subscription-based video game streaming was first attempted with OnLive, which launched in 2011 and boasted a variety of payment models. The company faced negative reviews due to lag issues and a small content library, and ultimately shut down in 2015 after selling its assets to Sony. Steve Perlman, the company's former CEO, expressed in an interview with Game Informer that he hopes Stadia will learn from OnLive's mistakes.

EA Access to launch on PlayStation 4 in July

A more established player in the video game subscriptions space is Electronic Arts, or EA, which first launched its subscription program EA Access on PC and Xbox One in 2014. The company plans to expand the service to the PlayStation 4 later this month, granting gamers access to titles such as "Madden NFL 19," "Star Wars Battlefront II" and "Need for Speed Payback."

Mike Blank, vice president of player networks at EA, noted that EA Access data shows subscribers not only flocking to big-budget new releases, but also experimenting with older, low-budget titles simply because they are available. This allows the company's studios to produce smaller, experimental titles that may not be marketable enough for traditional release. Blank added that, while video game subscription models are becoming popular, growth may not be infinitely sustainable.

"There aren't 50 gaming subscriptions in the market right now," he explained. "If we do reach that point, I do think people will have to choose. That means some of us will succeed, and some of us will not."

Ubisoft to launch subscription gaming service

That outlook has not stopped video game publisher Ubisoft, which recently announced its own gaming subscription service, Uplay+. The offering is scheduled to launch in September and will include access to more than 100 titles, including upcoming releases such as "Ghost Recon Breakpoint," "Watch Dogs Legion" and classic titles such as "Prince of Persia: The Sands of Time" and the entire "Assassin's Creed" series. Uplay+ will be available on PC and Google Stadia for $14.99 per month, while competitors EA Access and Xbox Game Pass are both available on PC and Xbox One at $4.99 and $9.99 per month, respectively.

New subscription offerings

Mercedes-Benz extends vehicle subscriptions to Atlanta

Mercedes-Benz is expanding its vehicle subscription program beyond Philadelphia and Nashville, Tennessee, to the Atlanta area. The offering grants subscribers access to 30 Mercedes models for a monthly fee. Atlanta was chosen because it is home to the automaker's U.S. headquarters and a growing population of high-income professionals.

Several competitors, including Porsche and Cadillac, have also been experimenting with subscription models as traditional car ownership declines amid the emergence of ride- and carsharing services. Subscribers can drive vehicles most suited to whichever tasks they need to complete — a minivan for a family vacation or a compact car for a daily commute, for example — rather than purchasing and committing to a single vehicle. These manufacturers have had mixed results with subscription models, however. Mercedes and Porsche report strong interest in their programs, but Cadillac shuttered its offering after only a year.

Hewlett-Packard announces subscription model

Another established company breaking into the subscription space is Hewlett-Packard. CEO Antonio Neri announced that all the company's products will soon be made available through cloud subscriptions. Hewlett-Packard will offer its computer servers, storage hardware, network equipment and software on a pay-per-use or subscription basis by 2022.

The company hopes this move will generate more recurring revenue, which has shrunk over the past year due to competition from cloud vendors like Amazon and Microsoft. Hewlett-Packard currently makes nearly half its sales through eCommerce platforms, including products sold on its HPE Store, its enterprise sales website HPE Elite and its Public Center Solutions storefront for government customers.

Blaize launches new subscription platform

London-based developer Blaize recently released a new digital platform for subscription enterprises. The offering allows companies to design and launch digital subscriptions that leverage identity and access management, a dynamic content delivery network and a data-driven firewall. Blaize's solution is geared toward businesses looking to shift from traditional models to subscription-based ones, and could account for 75 percent of direct-to-consumer businesses by 2023. Several media brands, including DC Thompson, Dennis Publishing, NewsCorp and TheStreet, currently use the solution, and Blaize recently raised €2.8 million ($3.1 million USD) from pan-European investor Nauta Capital to fuel further development.

Bank of America considers Merrill Edge subscription model

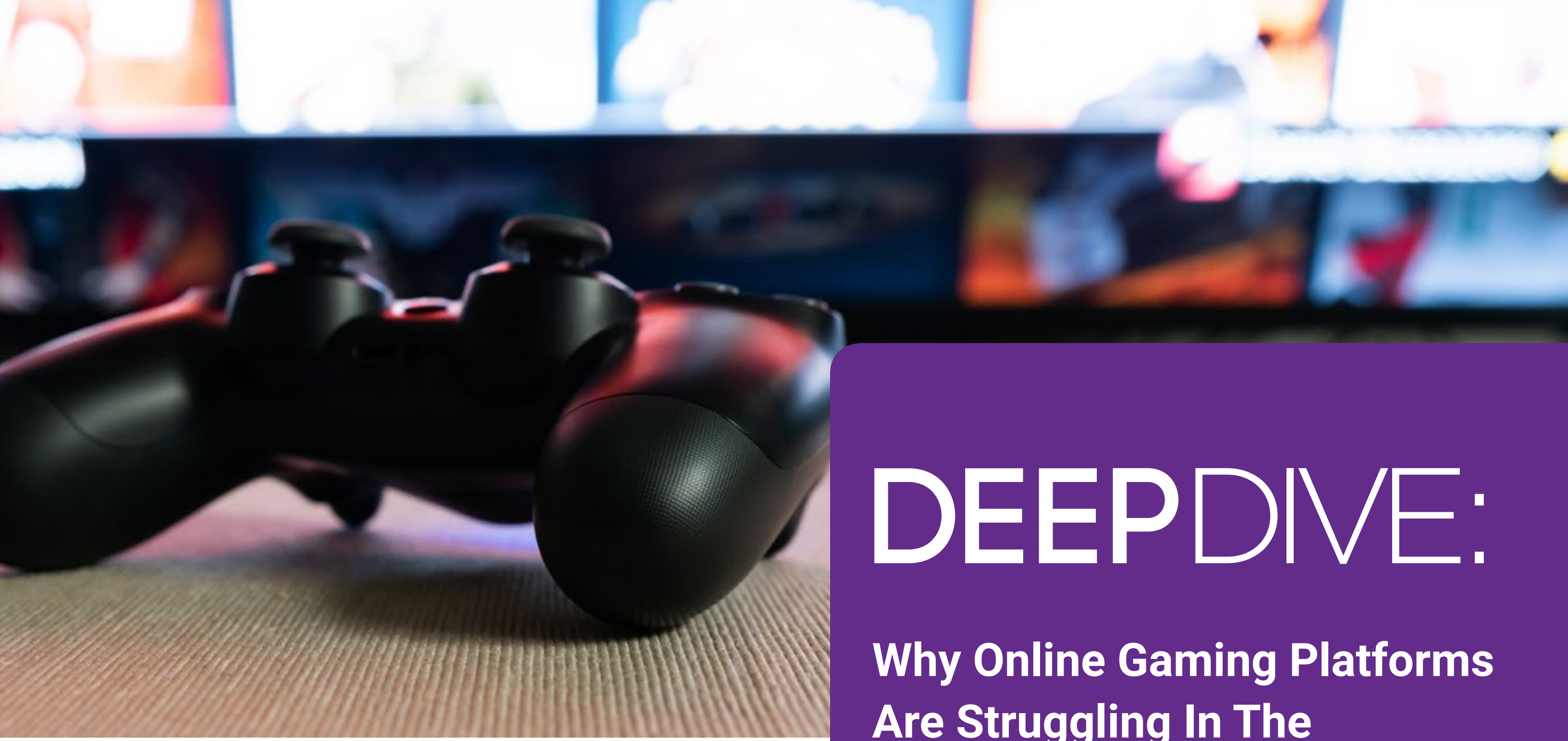
Bank of America is contemplating a subscription service for its Merrill Edge wealth management platform. Teron Douglas, head of digital capabilities for the latter, explained at SourceMedia's In|Vest conference in New York that "clients are simply getting used to paying [for] subscriptions," making the move "a logical next step." He added that the next part is "just a question of getting the pricing right."

Bank of America would become the second major Wall Street player to offer a subscription pricing model for its wealth management service, should the plan bear fruit. Brokerage giant Charles Schwab implemented such a service in April, resulting in more than $1 billion in new assets — 37 percent of which are from new customers.

AirMail shocks users with unannounced switch to subscription model

Not all transitions to subscriptions have gone smoothly, however. iPhone and iPad email client Airmail switched to a subscription-based pricing model this month with no warning to users. The app's premium features, which were previously available for a $4.99 App Store purchase, will now cost users $2.99 per month. Those who purchased the app retained access to all premium features except push notifications.

Users took to Twitter and Reddit to express their displeasure with the app's pricing change, which breaches an App Store guideline that states, "If you are changing your existing app to a subscription-based business model, you should not take away the primary functionality existing users have already paid for." Airmail developer Leonardo Chiantini said the decision to change the pricing model was made to maintain profitability after back-end service price increases.



DEEP DIVE:

Why Online Gaming Platforms Are Struggling In The Subscription Economy

The video game market was one of the first to move into the subscription economy, even before gaming went online. Companies like GameFly cropped up back in 2002, sending physical discs and cartridges to customers. Gaming subscriptions shifted direction as the world moved online, making things a little more complex. Providers needed to offer subscribers more if they were going to keep them satisfied in the emerging online gaming market, especially as customers no longer valued services that offered access to just one game at a time.

There are more than 2.5 billion gamers worldwide, and consumers are demanding more content, options and perks in their online subscriptions. This group is set to spend $152.1 billion on games by the end of 2019, putting pressure on gaming subscription services to offer competitive pricing, features and, above all, content. Subscribers want access to new technologies or support for mobile games, but gaming subscription services also need to cater to historic preferences that have been slow to change — even in today's digital world.

Mobile gaming is one of the fastest growing industry segments, but many gamers still utilize consoles. Digital gaming is popular with players worldwide and most feel a sense of ownership regarding the online games they stream, making it difficult for providers to be fast or flexible enough to remain competitive.

Gaming companies will need to approach subscription services in a way that engages customers who want the same personalized experiences they receive when picking out games in-store, particularly as online gaming continues to expand and more gamers join its ranks.

Competing in a global subscription market

Most gaming companies are competing on a global scale, meaning subscriptions need to appeal to gamers everywhere from Asia to Europe to the U.S. Some companies decided to emulate media subscription service Netflix to craft a universally appealing experience. Technology company Microsoft moved into the space with the launch of its Netflix-style GamePass subscription service for first-party games in 2017. The offering allowed gamers to play new games without having to purchase them outright, which can cost consumers upward of $60 per title. The service has steadily added subscribers since its release, with one title, "Sea of Thieves," amassing 5 million participants.

Microsoft was quick to have competition in this area, with gaming firm EA releasing a premium subscription solution of its own: Origin Access Premier. The offering was an extension of a service that granted gamers a few hours of pre-release play on the Xbox One console, as well as discounts on EA games. Subscribers could also play games as soon as they were available for purchase. EA's service eventually changed how gamers approached online gaming, with many playing for longer, spending more money on games and interacting with a larger range of content. Other companies, including Sony, took note of the boon that could be reaped from such offerings and released similar services.

These subscription services remain popular, but companies are now faced with users who want personalized content across various channels.

Mobile gaming and the future of subscriptions

This shift is clearest when it comes to mobile gaming — a space that is becoming popular as smartphone usage grows around the world. Mobile game "Fortnite Battle Royale" currently has 250 million players around the globe, and thanks to Chinese telecommunications company Tencent's stake in the game, the country remains a leader in the market. The U.S. is slated to overtake China as time goes on, particularly as 5G networks rise across the country.

The mobile gaming market has grown more than 10 percent YoY since 2018, reaching $68.5 billion and comprising 45 percent of the global gaming market. A full $54.9 billion of that figure was generated by smartphone games alone, indicating that mobile gaming is an important area that subscription services should consider for future success.

Subscription services will likely need to pivot their approaches once again to entice mobile users on a global scale. They will also need to make sure their offerings are as personalized as possible to connect with users as the global online gaming market grows and expands.

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