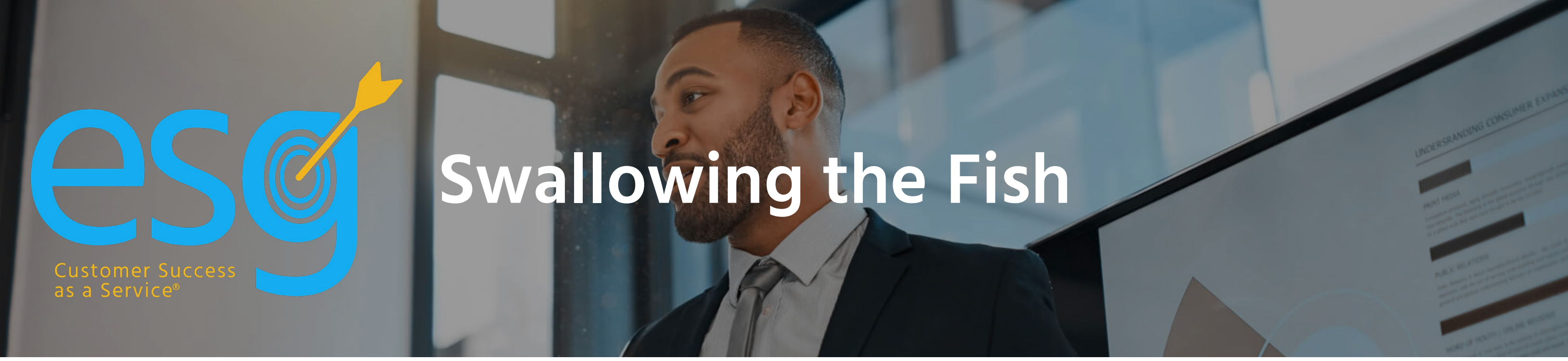


Swallowing the Fish

The phrase "swallowing the fish," from TSIA's Technology-as-a-Service Playbook, gets tossed around frequently in the technology industry. Even though it sounds like an instruction on eating seafood, the term refers to the transition from technology as an asset to technology as a service.

What's the difference? An asset is something you buy and then have at your disposal when you want to use it. A service is something that's provided for you, month after month or year after year, in exchange for regular payment.

Take one example that your company has likely had to contend with: data backups. You probably have terabytes of data associated with your company's assets and software — substantially more if you deal in photos and video – and all of that data has to live somewhere.

You could spend thousands or tens of thousands of dollars on a server rack, the hardware and software to manage it, the power to run it, and an IT professional (or several) to set up and maintain it. Or you could subscribe to a large-scale data backup company that will upload your data and maintain it on their own servers for a monthly fee.

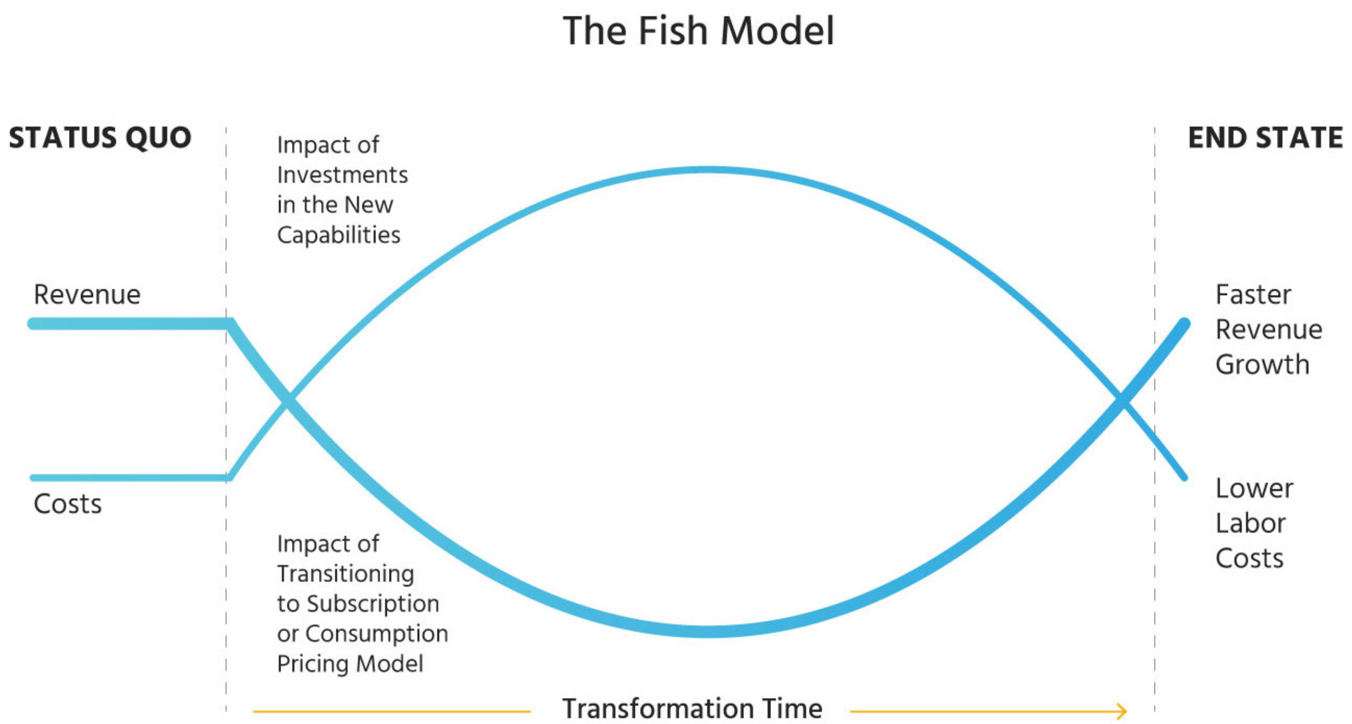
There are pros and cons to both. If you buy your own servers, you own that asset and can do with it as you please until it breaks or you need a new one. In the long run, it might even be cheaper than a perpetual subscription. On the other hand, you'll be responsible for all hardware and software upgrades. You're responsible for maintenance when a drive goes bad. And if there's a power or network outage, it's your problem to fix.

In the technology world, more and more companies are transitioning their business models away from selling technology as an asset and toward technology as a service — a subscription- or annuity-based model. According to BMC, the SaaS (software as a service) sector has grown from $58.8 billion in 2017 to $85.1 billion in 2019, and it's expected to hit $113.1 billion by 2021.

But that transition isn't as simple as flipping a switch. Migrating to a subscription-based model requires thoughtful transformation of your current business practices, including time, patience, and money, to work through that transition.

Chapter One: The Fish Framework

The “fish” in “swallowing the fish” refers to the shape of the graph below.



This graphic charts two variables — revenue and costs — over time as a hypothetical company transitions to a subscription-based model. This is a simplified version, and every company’s transition will look different, but the basic idea is that this transition will take the form of four stages:

1. The status quo: whatever your business looks like right now, before the transition.
2. You start transitioning to a subscription model. Revenues drop as you start replacing big upfront contracts with smaller monthly fees. Simultaneously, costs rise as you invest in new capabilities and infrastructure (like Customer Success) to support your new offerings. Your profits drop or even vanish entirely.
3. As the transition gains some momentum, revenue from subscriptions starts to rise. Costs fall with scale and as delivery efficiency increases. Subscriptions start to become a viable source of revenue.
4. Subscription revenues overtake costs, and then some, as your company re-enters the black. Furthermore, revenue continues to rise and costs continue to fall, increasing profits to above your pre-transition numbers.

Unsurprisingly, many leaders, especially C-suite executives, do not like the fish. The fish represents a substantial risk — offering reduced profits or even a loss for several years, gambling that an entirely new economic engine will be better than the status quo.

Some businesses will even dig their heels in, refusing to change as new competition starts to steal away their business. You need only look at the recent history of Blockbuster or Borders Bookstores to see that staying put presents risks of its own.

Chapter Two: Making the Transition

At this point, you're probably thinking, "why take the risk?" Why sacrifice three to five years of profits on a venture that might not work? And how much do you have to lean into this new strategy?

Nothing Ventured, Nothing Gained

The first reason to make that leap is the promise of the right side of the fish. If the transition is executed correctly, the new business model can be vastly more successful than the old one. Yes, you might be operating at a loss for a few years, and that won't always be easy or pleasant, but you must think of those losses as an investment, just like the cost of opening a new office or hiring new people.

If that period of loss is followed by a decade of far higher profits, then you've just made the whole venture worth it. Like any other significant expenditure, this transition is all about gauging the risk against what you stand to gain.

In this case, the return on your investment can be enormous. Not only are subscriptions a more lucrative income source in the long term, but your costs will be significantly simplified. Consider the example of Adobe's Creative Suite. The status quo was software fragmentation — customers might be using CS4, CS5, or CS6. That meant that menus, file formats, and support questions were often incompatible across machines.

Now that Adobe has switched all of its offerings to Creative Cloud, they control the software. Since everyone is connected at all times, everyone is always running on the same version. If Adobe wants to add or remove features, they can force that update across every account. That makes maintaining and supporting their offerings far simpler.

Fear of Being Left Behind

The other major reason to make the transition to a subscription business model is simple: because you might have to. When your industry takes a substantial leap forward, it can be easy to get left behind if you're not on your toes.

In 2006, Apple's iTunes was the undisputed king of the music market. You may even have an old iPod with a library full of songs you've long forgotten about buried at the bottom of your desk drawer as you read this. To refresh your memory, iTunes customers paid a flat rate per song or per album, at which point they could download an MP3 to their computer or iPod and that file was theirs to keep.

Then Spotify came along, offering a new model. Instead of paying per song, subscribers can listen to anything in Spotify's library as many times as they want, in return for a monthly paid (or free, adsupported) subscription. Spotify skyrocketed in popularity, recently becoming the first music streaming company to hit 100 million paid subscribers.

Apple had no choice but to follow suit. Early in 2019, Apple announced that after 18 years, they'd be shuttering iTunes in favor of Apple Music, a subscription-based replacement.

In virtually every industry, but especially in the tech world, competition abounds. Customers, now spoiled for choice, are no longer willing to pay a premium for incremental advantages when it's so easy to just switch to a competitor. Combine that with the increasing success of "as-a-service" businesses in every sector, and swallowing the fish is becoming a financial necessity.

How Committed Should You Be?

The level of commitment you make to your new subscription-based offerings is up to you, but there will be trade-offs with whatever you decide.

If you go all-in, you'll make an aggressive pivot to the new economic engine. You'll transition as much of your company's revenue as possible to a subscription-based system, even going so far as forcing customers to transition. Adobe is a good example — customers who still own old software can keep it, but they can't update it, and there's no longer an option to buy a perpetual license for Adobe products.

Going all-in is faster, which means you'll reach the lucrative ground on the right side of the fish more quickly, but it's also riskier — your short-term hit will be more severe, and you risk alienating customers who don't want to transition.

If you take a more timid approach, just dipping your toe in the subscription model, you'll start offering a subscription while hanging on to the old model simultaneously. Your hope is that the new subscription model catches on and customers make the switch on their own because they recognize the value, but you're not forcing it.

This may be a safer option, since you're not putting all your eggs in the subscription basket, but it's also much slower, and you'll end up at the mercy of your customers. If they prefer to stick with the status-quo or if they don't understand the value of your new subscription model, you'll need to go back to the drawing board once again.

Chapter Three: The Four Phases of the Fish

The fish transition takes four major phases, and each phase requires specific preparation and tracking. You'll also want to know what the signs of success are — the point at which you know it's time to move to the next phase.

Phase 1: Alignment

The first phase of your transition will be full of planning. Everyone in the company, from sales and marketing to product development and Customer Success, needs to be on the same page about what the future of your company will look like. For example:

1. Will you have new tactics and strategies to promote and sell subscriptions rather than licensed software?
2. What specific pricing plans will you offer? Will you offer different packages over time, or to existing customers?
3. Will this change in product offering change your target market? How many customers do you expect to lose in the transition, and how many might you gain?
4. How long will all this take? How much time can you afford to spend? Do you have the cash on hand to invest aggressively in new channels, or will you try to take the transition more slowly?

The next step is to assess your ability to deliver the new product offering. This is where investment comes in — do you need new salespeople? New infrastructure? A larger Customer Success team? A more robust CRM?

Take the time to review your legacy portfolio — the securities, cash, and other assets that you have on hand to keep your company afloat during this period. This portfolio will help inform how much time you have to complete the move and how aggressive you can be.

Finally, optimize the delivery of the new product. If you ask customers to transition to a subscription-based model, only to find that there are major obstacles to delivery and onboarding, you'll frustrate them and drive them away. Make sure systems are in place for a seamless experience before you get started.

Phase 2: Announcement

The second phase is when leadership informs everyone, employees and customers alike, about the new plan. Be transparent with your team about how much revenue you expect to bring in over the next few years, and be explicit about which metrics you'll be using to track progress in the meantime.

In this phase, you'll also describe the new LAER (land, adopt, expand, renew) process that you'll be guiding your customers through, as well as how your organization will be structured to make that happen.

Finally, you'll clearly lay out your new KPIs — subscriptions, churn, renewals, and so on. If you can't accurately measure customer adoption of the new system, you won't know whether you've succeeded or not. Once new KPIs are in place and you're set up to monitor them, you're ready for the next phase.

Phase 3: Demonstration

This is the phase where you start to really show that the new model can work. You may not be back to profitability yet, but subscriptions are growing and customers are starting to make the switch. It's important to keep in mind that this is where your investments will peak — you need to dedicate a substantial amount of time and energy, which let's face it, typically means money, into making sure your customers can smoothly make the transition, realize the value of the new product, and adopt it into their workflows so that they'll renew when the time comes.

Customer Success is crucial in this phase. Getting customers to renew is like rolling a snowball down a hill — once they start to build momentum, it's much easier to keep that momentum going.

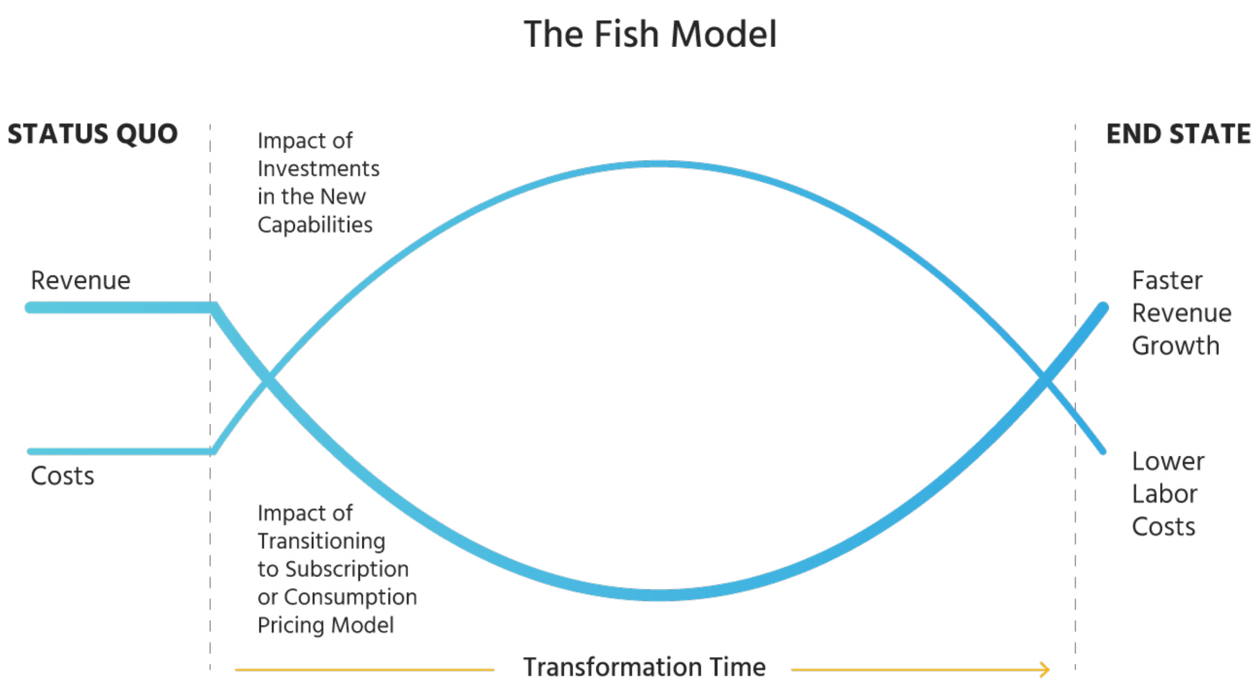
That's where ESG comes in. We offer Customer Success as a Service™, using a programmatic approach and our own experienced CS professionals to fill in the gaps in your abilities and ensure that even your smallest customers are successful.

During the demonstration phase, you'll be closely monitoring the KPIs that you set for yourself in prior phases. Once they start to show improvement and revenue is on the upturn, you're ready for the final phase.

Phase 4: Declaration of Victory

You did it! You successfully navigated this difficult transition period and came out on the other side. You've returned to profitability, and your metrics reflect that your new model is a viable option moving forward. Now, all that's left is to optimize.

In order to widen the profit margins on the right side of the fish graph — remember, that was part of the reason we did this in the first place — you'll need to optimize both pricing and costs. Pricing will likely have an element of trial and error as you determine exactly what your customers are willing to pay for your product.



You'll gain insights into the long-term value of your customers. What's the age of your average account? How long do customers keep an account before they upgrade? How much does pricing affect those two numbers? The more data you collect on your customers' buying behaviors, the more you'll be able to set the perfect price for your offerings.

You'll start to deliver more efficiently, saving money on costs at your end. You'll fine-tune your onboarding and education processes, so you can dedicate less time getting new customers up to speed. Your satisfied customers will start to refer new customers — the Advocacy stage of the customer lifecycle — saving you time on marketing and nurturing leads. The customers that fully adopt your product will start to auto-renew, so you won't have to re-sell to them again year after year. The list of new benefits to your business after successfully swallowing the fish could go on and on, but we digress.

The Bottom Line

The move to a subscription-based model won't be easy. It will take significant patience and investment, along with a short-term loss of revenue, and you'll have to plan and execute every phase of the process carefully to make it work.

But the advantages, both in terms of short-term profitability and long-term adaptability to a changing market, are undeniable. Business is always changing, and no one can predict exactly where the tech industry will turn next. What we can predict is that by offering your product as a service, rather than an asset, you'll be better positioned for whatever comes next. The switch to a new system is difficult to swallow, but swallow it we must.