Can the Subscription Economy Save Financial Services?

By Wolfgang Ulaga , INSEAD Senior Affiliate Professor of Marketing, and Michael Mansard , the Subscribed Institute

The traditional FSI business model is looking threadbare – and not only because of the pandemic. Some players are seeking new territory by transitioning to subscriptions.

As the world waits for mass vaccination to revive economic activity, general malaise has overtaken the financial services industry (FSI). And things will probably worsen before they get better: US banks are expected to suffer **US$318 billion in net loan losses** by the end of 2022, according to Deloitte. But the extraordinary economic impact of the pandemic has only intensified mortal threats to the industry's business model that have been brewing for years. If the global economy were to recover completely tomorrow, FSI incumbents would still be in a highly precarious position. In **a new whitepaper**, we argue that going back to the pre-Covid "normal" is not an option for financial services. Fortunately, the **rise of the subscription economy** points towards frontiers of untapped growth for the sector.

Shaky ground

Growing regulatory pressures, low interest rates, digital disruptors (both fintech and Big Tech) and savvy customers demanding better experiences at lower costs all have put wide cracks in the FSI's legacy business model. We'll confine our argument here to two key revenue streams.

First, the pervasive and persistent low-interest-rate environment has severely impacted profitability since the 2008 global financial crisis. As interest rates are determined by central banks, FSI companies have no control over this destructive and volatile aspect of the business. The Covid-19 fallout has increased downward pressure on interest rates, which have dipped into negative territory **in many countries**. It is safe to say that there is no short-term end in sight to this trend.

Second, customer fees may no longer be as reliable a revenue source, due to competition from fintech start-ups with no reverence for Big Finance's customary practice of arbitrarily bundling popular services with less loved ones. While bundling fosters the perception among customers and regulators that the FSI's pricing is untethered to value, fintechs have homed in on what customers really want. With tech-savvy and agility outstripping that of incumbents, they have been carving business away from established players – a trend set to accelerate amid Covid-fuelled digitalisation.

An even more formidable enemy than fintech may be Big Tech. Amazon, Facebook and Google have deep and broad reserves of customer data with which to further their encroachment into Big Finance's domain. Amazon, for example, has teamed up with banks to offer **short-term business loans** to platform sellers looking to scale up.

The traditional FSI model, therefore, is beset on all sides by fierce competitors and sorely in need of renewal. The **plummeting market caps** of many large banks – outrun in recent years by fintech and cloud companies – attest to this. By contrast, subscription businesses remain on a general growth path despite the economic downturn, **according to research from Zuora**.

Shifting to a subscription mindset

The FSI's troubles largely stem from a well-established inward-looking business model relying on high predictability, stable revenues and rather passive customers lacking bargaining power. Adopting the philosophy of subscription-based companies such as Netflix could help incumbents out of the trap. Subscription firms take customer-centricity as a core principle. Their main priorities are retaining subscribers, monitoring usage, accounting for recurring revenue and finding new ways to inspire customer loyalty.

Subscription economy principles would also give the industry a reality check about demand. When you get down to it, people engage with financial institutions as the need arises, whether it be a mortgage, car loan, insurance, etc. Most customers would not drop into their local bank branch just to see what's new. Subscription thinking would enable FSI companies to lean into customer habit, instead of ignoring or resisting it. Customers should be able to acquire and drop services, or scale them up or down, as easily as they sign up or terminate an Amazon Prime or Netflix account. It sounds counter-intuitive, but the Subscribed Institute has found that allowing customers to suspend subscriptions may prevent them from cancelling for good, in as many as 1 in 6 cases.

Subscription economy use cases

The FSI's transition to the subscription economy has been slow, but there are a growing number of successful use cases nonetheless, more than 30 of which are covered in our whitepaper.

The insurtech start-up Lemonade (the subject of a **recent case study** co-written by Wolfgang), although not an incumbent, demonstrates one strategy for leveraging the subscription economy within the FSI: reinventing an existing service – in this case, homeowners' and renters' insurance – as a streamlined and customer-centric experience. Through a smartphone app integrating AI and machine learning, Lemonade can on-board policyholders in a minute and a half and fulfil claims within seconds. Customers can cancel and modify policies in just as little time. Indeed, Lemonade actually refers to its policies as "subscriptions" on its website.

Capitalising on digital speed and scale, Lemonade is quickly closing the data gap with established insurers, some of which had a decades-long headstart. This creates a virtuous cycle: The larger Lemonade's data reserves grow, the more powerful its algorithms become. Beefed-up automation generates efficiencies and the ability to lower fees – which are already setting industry standards for affordability – even more and attract more customers, leading to more data, etc.

Insurance is low-hanging fruit for the subscription economy, since monthly premiums are so structurally similar to subscription fees. But Lemonade demonstrates how embracing the subscription mindset can turn a boring hassle into an effortless and fun experience for the customer at a fraction of the cost.

Sberbank, Russia's largest financial institution, has gone a good deal further with the subscription economy, creating a suite of digital services (called SberSolutions) for outsourcing financial, operational, legal and HR tasks. The advantages for Sberbank in expanding into adjacent areas go beyond the revenue accrued through subscription fees. Customer engagement at this level is sure to yield actionable insights that add real value. For example, an accounting algorithm could alert enterprise users to the likelihood of an imminent cash-flow problem, and direct them to a Sberbank loan officer.

Subscription-powered expansion into adjacencies could help FSI firms beat fintechs at their own unbundling game, by spinning off popular **free services into "fee"-based offerings** generating both revenue and data. It could also fend off incursions from Big Tech, through gaining and leveraging industry-specific customer insights that are as deep as Google's are wide.

Finally, banks that have been compelled by governments to adopt an open API infrastructure are looking at ways to monetise **data and insights as a new growth area**, rather than hoping to capitalise solely upon the underlying product accessed by the API (e.g. customer spend analytics, fixed income and equity indices).

Becoming the catalyst

The most forward-looking – and probably the most transformative – way for FSI firms to take the subscription plunge is to help the rest of the economy do so. Transitioning from a one-off payment structure to a recurring one is not without its challenges. Companies will be looking for the right finance partner to help them manage risks such as: short-term deficits that may arise from a more patient business model; damage, theft or breakdown of physical equipment leased to the end consumer; the negative effect on the balance sheet caused by turning an item from inventory into an asset, etc.

For example, **BNP Paribas Leasing Solutions** helps companies large and small regulate the lifecycle of their assets in accordance with circular-economy principles. Its innovative financing makes it possible for firms to weather the financial ups and downs of "pay per use" and circular models.

Alongside financing, FSI companies already have a number of other "building blocks" – such as payment gateways and insurance to cover new risks – that could be combined into an all-round solution for the subscription economy.

As the above examples suggest, you don't need to change your entire organisation or have a detailed, multi-year plan in place to enter the subscription economy. In fact, our recommendation is to be cautiously experimental. Start with fast-paced, narrow trials, and when you find success, expand from there. However, we've discovered that the heavy coordination demands of the subscription economy may challenge an industry famous for legacy structures and processes. Even a partial switch to a subscription-based model will require parallel adjustments from finance, sales, marketing, etc. Now more than ever, preparing for the organisational future means busting through silos.

Download the full whitepaper here.

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