And the Oscar Goes to...the Subscription Model

In 2017, Amazon Prime Video made history when it became the first streaming video service to win a best picture Academy Award nomination for *Manchester by the Sea*. This year, Netflix joined Amazon with a best picture nomination for its original feature *Roma*, while streaming rival Hulu got a best documentary nomination for *Minding the Gap*.

These nominations show more than a power shift from traditional movie studios to online streaming companies. They show the power shift from the transactional to the subscription model in the internet economy—and the intense competition to succeed within that model.

Historically, subscriptions are most familiar with print periodicals. Magazines and newspapers long relied on both the recurring revenue of subscriptions and the transactional revenue of advertising and newsstand sales. Traditionally, advertising was by far the greatest proportion of revenue. Subscriptions were a minor revenue source or sometimes free, intended to demonstrate a large enough circulation to attract advertisers and justify advertising prices. In 2008, advertising revenue made up 60 percent of total revenue for *The New York Times*, while subscription revenue made up 30 percent.

However, as the internet commoditized the news and supplanted print newspapers with an easy-to-use digital platform, advertising revenue plummeted. Once the *Times* developed its own digital platform with unique and compelling content, its revenue mix flipped. In 2018, subscription revenue (mostly digital) made up 60 percent of total revenue, and advertising revenue (also mostly digital) made up 32 percent.

Benefits of the Subscription Model

When successfully executed, the subscription model offers alluring benefits: a recurring, relatively predictable revenue base, and an opportunity to cross-sell to engaged consumers. The model is especially appropriate for the internet economy, with the ascendance of convenient digital platforms that can be used to create an ecosystem of diverse, complementary products.

The markets are rewarding companies that use the subscription model. Scott Galloway, a New York University professor and expert analyst of the internet economy, points out that investors favor companies that rely heavily on a subscription model, compared to those that rely on individual transactions for revenue. Netflix and Adobe have a much higher price-to-sales ratio at more than 10, compared with Walmart and Ford at less than 1. Galloway’s conclusion: “Markets are telling firms if they don’t... move to a recurring revenue model, they are going to end up alone living with cats.”

What It Takes to Succeed

Amazon and Netflix are two titans of the internet economy’s subscription model. As of 2018, Amazon Prime had more than 100 million U.S. members, up from 40 million at the beginning of 2015; Netflix had more than 57 million U.S. subscribers in 2018, up from 45 million in 2015. The battle between these titans highlights the absolute requirement to succeed in the subscription model: content that is broad and compelling enough to warrant regular, sustained consumer engagement.

Amazon and Netflix are in an arms race for video content that will drive subscriptions and engagement. In 2018, Amazon invested an estimated $5 billion in original video content, while Netflix invested $10 billion. Both companies are expected to double that spending in five years.

For Amazon, however, subscription-based content is a loss-leader for a broader revenue play. By attracting viewers with compelling, original content for Prime Video, Amazon opens a new door into its vast Amazon Prime ecosystem of online shopping, streaming media services, retail outlets, Echo-linked devices, and more. As Amazon CEO Jeff Bezos has said, “When we win a Golden Globe, it helps us sell more shoes.”

Subscription Healthcare

Healthcare’s traditional fee-for-service revenue model has been built on individual transactions—the more transactions, the more revenue. Further, healthcare transactions typically are highly episodic. Healthy people may see a provider once a year, if that. Specific illnesses or injuries involve intensive provider interaction, but often only for a short time.
Although healthcare may be episodic, health-related activities are omnipresent. More than 300,000 health-related apps seek to take advantage of this omnipresence with tools for a wide range of activities, such as provider communication, fitness tracking, meditation, and remote monitoring. However, healthcare has barely begun to create a cohesive ecosystem of diverse health-related services that could support a contemporary subscription model.

Concierge medicine is an initial foray into the concept of recurring revenue models. For a set fee, consumers receive amenities such as same-day appointments, more time with their physician, and the ability to email, text, or videoconference a clinician with questions during and after office hours. The concierge medicine model, however, has been driven largely by physicians and practices that want to see fewer patients, not more.

The question for healthcare providers facing the internet economy’s disruptions is how to build a subscription-based service that is both attractive to consumers and scalable. Telemedicine startup 98point6 is trying to answer that question with its intent to become “the Amazon Prime of primary care.” For a flat fee, consumers get all the primary care they want, delivered through a text-based service accessed through a mobile app. The company offers two subscription models: a personal plan in which consumers subscribe and pay individually, and an employer-based plan, in which companies cover the fee for employees. Leading the effort to scale the model is Chief Product Officer Rob Schwietzer, who is—not coincidentally—the former head of Amazon Prime.

98point6 has some challenges in its path. First, it uses a unique engagement model. An automated assistant handles the initial part of the patient encounter (clinical history, description of symptoms) before the physician takes over for diagnosis and treatment. Interactions with the physician are primarily text-based. Consumers in the U.S. have mixed feelings about artificial intelligence and text-based services. There are significant generational differences, and majorities of both millennials (ages 18–37) and Gen Xers (ages 38–53) prefer text-based over voice-based solutions.

Second, even with the use of automated assistants, 98point6’s business model still relies on access to live physicians. This could constrain scalability of the model, or detract from the consumer experience if patients have to wait too long before gaining access to a physician.

Third is the fundamental question of whether the service provides enough compelling content to justify the price. In the employer-based subscription model, where cost to the employee is essentially zero, the service has a 6 percent utilization rate. While this is better than the 3 percent utilization rate commonly seen with employer-provided telemedicine services, it suggests that many employees are either unaware of the service (a solvable problem), or not attracted to it (a bigger problem). With respect to the individual model, there are roughly 1.6 primary care visits per person per year in the U.S. At this level of utilization, 98point6’s introductory subscription price of $20 for the first year might make sense. But will consumers feel they are getting sufficient value when that price rises in subsequent years?

Despite these questions, the emergence of 98point6 shows that innovators and investors see subscription-based opportunities in healthcare. It isn’t hard to imagine how companies with richer content offerings could see similar opportunities. The premium model for health insurance already resembles a subscription-based plan. As Aetna becomes part of the CVS Health platform, or UnitedHealth Group seeks to leverage Optum’s growing platform of digital and clinical services, subscription-based models could open new doors to an extensive ecosystem of compelling health-related benefits for current health plan members and new subscribers alike.

Legacy health systems need to take a serious look at the potential of subscription-based models. For most, developing the optimal blend of technology and physical and virtual access points needed to build and maintain a platform will be a major first step. The biggest challenge, however, is the same one that faces any subscription-based business: creating a content-rich ecosystem. Organizations must build a suite of offerings that engages consumers again and again, building loyalty through an experience that features easy access, diverse services, and premium content at an attractive price.

Succeeding in the subscription model has been a big leap for giants like Amazon and Netflix, and it may be an even bigger leap for legacy healthcare organizations, given its slow speed of technology adoption. Yet, the goal of continuous, digitally enabled engagement is the goal of the internet economy. Difficult or not, this is the world in which legacy healthcare needs to succeed.

Your comments are welcome. I can be reached at kkaufman@kaufmanhall.com.