

Pricing Strategies in Subscription-Based Media: Analyzing Revenue Optimization and Customer Satisfaction

Kushagra Sadwal¹ and Tom Cha[#]

¹West Windsor-Plainsboro High School South, USA

[#]Advisor

ABSTRACT

Subscription-based media companies, including streaming services and digital content platforms, have revolutionized the media industry by adopting business models that focus on profitability and continuous revenue streams. This research paper examines the strategies these companies employ to price their subscription models to maximize revenue and enhance customer satisfaction. This paper delves into the complexities and considerations that influence these decisions by analyzing pricing strategies such as tiered pricing and freemium models. Additionally, the study explores quantitative data from industry reports and company financials are used to provide a comprehensive analysis, with a focus on churn rate, engagement, price elasticity, and average revenue per user (ARPU).

Introduction

The shift from the traditional media monetization models to subscription-based services – where customers can choose how much they want to watch - has transformed the media landscape. Companies like Netflix and Spotify have demonstrated the viability and profitability of recurring revenue models. This paper explores how these companies design their pricing strategies to achieve optimal revenue while maintaining high levels of customer satisfaction. Understanding these mechanisms is crucial for media companies looking to thrive in a competitive and dynamic market.

Literature Review

The transition from traditional media consumption (cable TV subscription at a fixed price and movie tickets) to access anytime, anywhere on any device —where customers pay periodic fees to acquire goods and services—defines the subscription economy. In the media sector, these models have been especially effective, enabling businesses to establish consistent revenue streams and cultivate enduring client relationships.

According to Zuora Financial Subscription Economy Index (SEI), 78% of individuals worldwide have subscription services as of 2021 (far higher than 71% in 2018), and 75% of respondents thought that people would own fewer physical items and subscribe to more services in the future. They further reported revenues of subscription companies in the SEI 6 times faster than the S&P 500 from 2012 to 2021.

Further, according to Statista the subscription economy has grown by over 250% since 2017, about five times faster than revenues of S&P 500 companies. In 2024, the global market for subscription video-on-demand (SVOD) services is projected to be valued at \$182.2 billion and is projected to reach \$231.5 billion by 2027 (Statista, 2024) with a CAGR of 8.27%.

The Two Pricing Strategies

Tiered Pricing

Offering multiple subscription tiers with varying levels of access and benefits.

Pros:

- Market Segmentation: Targets different customer segments with varied pricing, broadening reach.
- Upselling Opportunities: Encourages customers to upgrade for more features, increasing revenue.
- Revenue Maximization: Higher tiers cater to customers willing to pay more for premium services.
- Flexibility: Offers options to customers, reducing churn by allowing downgrades instead of cancellations.

Cons:

- Complexity: Managing multiple tiers can be administratively challenging.
- Cannibalization Risk: Lower tiers might reduce demand for higher-priced plans.
- Perceived Inequity: Poorly differentiated tiers may lead to dissatisfaction.

Freemium Model

Providing basic content for free while charging for premium features.

Pros:

- User Acquisition: Attracts a large user base with low barriers to entry.
- Network Effects: A larger free user base increases the service's value.
- Upsell Potential: Converts free users to premium customers.
- Brand Awareness: Increases visibility and organic growth.

Cons:

- Low Conversion Rates: Only a small percentage of users may pay for premium services.
- High Operational Costs: Supporting free users can be expensive.
- Devaluation of Premium: If the free version is too good, users may not upgrade.
- Dependency on Premium Users: Revenue depends heavily on a small percentage of paying users.

Methodology

The research utilizes a mixed-methods approach, combining quantitative data analysis of subscription revenue patterns with qualitative case studies of leading media companies. Data sources include financial reports, market research studies, and customer surveys. It is also important to mention that all this data that involves Netflix relates to the UCAN/North America region as the subscription-based media industry is more developed and accessible to their population. Spotify, however, doesn't disclose by region on its main financial sheet.

Some common formulas used in gathering data for different graphs and tables include:

1. Churn Rate= (total lost subscribers/paid memberships at the beginning of a quarter)
2. Netflix Revenue=Average Paying Memberships×Average Revenue per Memberships

or

$$=\sum(\text{Number of Subscribers in each Plan} \times \text{Subscription Price for each Plan})$$

3. Spotify Revenue=Average Number of Users×Average Revenue per User
4. Subscriber Life=1/Monthly Churn Rate
5. Subscriber Life Value=Subscriber Life×Value*

*ARPU, Gross Profit, EBITDA, Free Cash Flow

Findings and Evaluation

Netflix (Tiered Pricing)

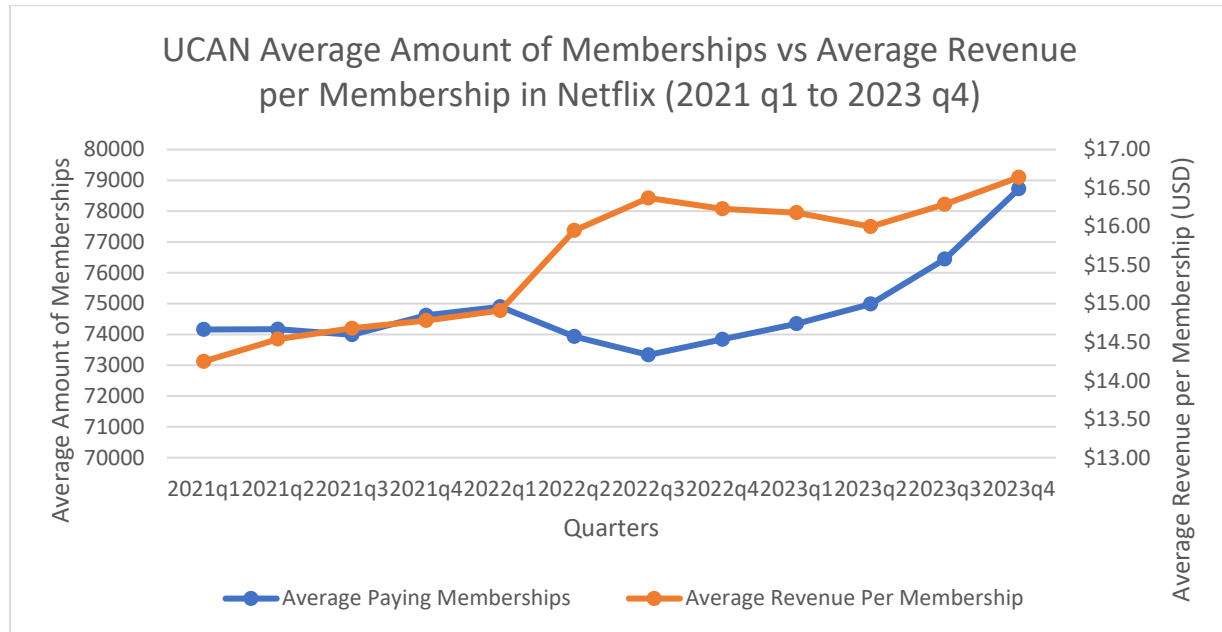


Figure 1. Based on Netflix 2023 q4 financials

Pricing Changes

Netflix has implemented price increases multiple times. With the long-term goal (proven by their 2023 q4 call), of raising prices by improving content quality and diversity Netflix is constantly increasing its prices. For example, according to Flixed, in January 2022, the basic plan up \$1 to \$9.99, the standard plan in the U.S. was raised from \$13.99 to \$15.49, and the premium went up \$2 to \$19.99. This price increase, like others in the past (such as 2019 and 2020), followed periods of significant investment in original content, which has been a cornerstone of Netflix's growth strategy. This is proven by the fact that even though their average amount of paying memberships decreased their average revenue per user increased offsetting the difference.

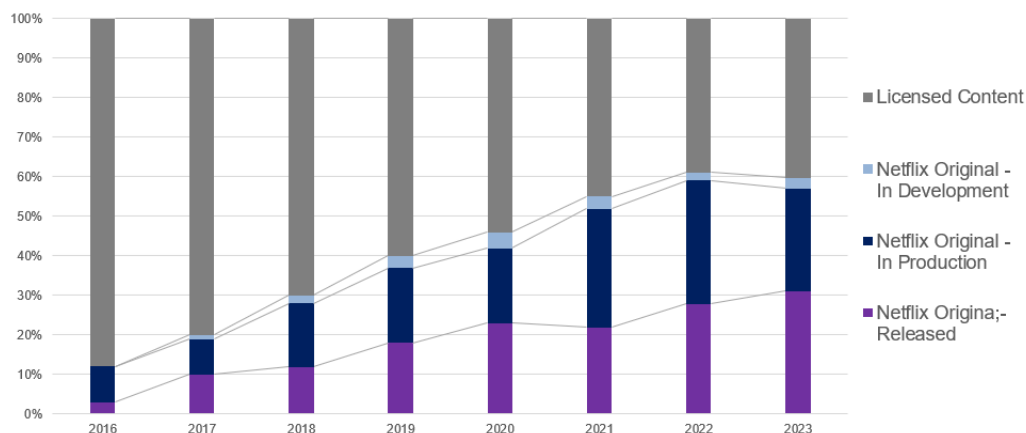


Figure 2 Depicts a breakdown of Netflix content (from Netflix annual reports)

Original Content Impact

The expansion of Netflix's original content library has been closely tied to its pricing strategy. As the volume and quality of original content increased, Netflix leveraged this to justify higher subscription costs. The data shows that despite price hikes, the average paying memberships in the U.S. region continued to grow, from approximately 74 thousand in Q1 2021 to close to 78.7 thousand by Q4 2023.

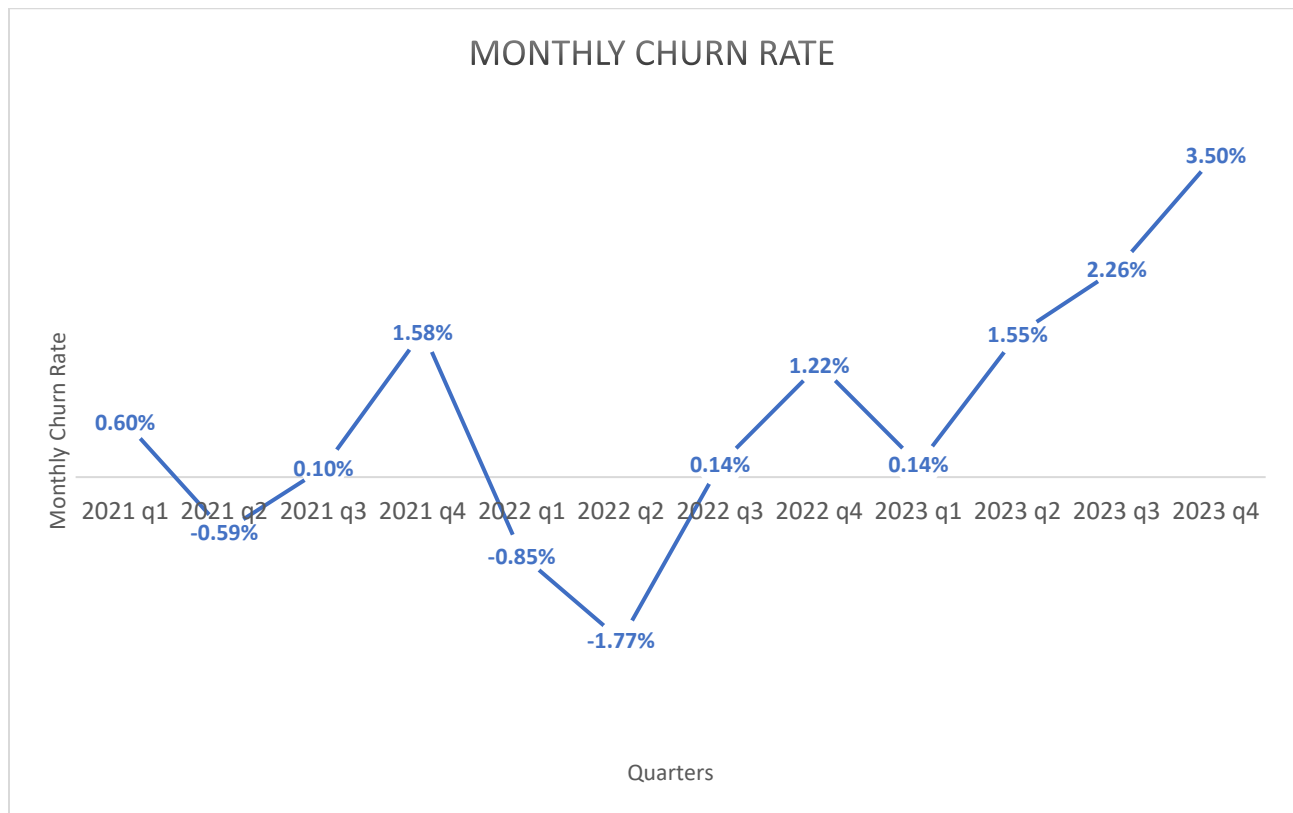


Figure 3. Based on 2023 q4 financials

Churn Rate

Price rises at Netflix have frequently caused brief increases in turnover rates, indicating how sensitive customers are to price increases. For instance, the churn rate increased from 1.4% in Q4 2021 to 1.55% in Q1 2022 following the price increase in January 2022. These increases in churn, however, were only temporary as long as Netflix kept releasing well-liked original programming. This tendency was also noticed after price hikes in the past, including in 2019 and 2020, when Netflix's robust content selection helped to offset early churn surges. In general, price increases do cause a temporary rise in churn, but Netflix's original content investment has been successful in keeping users, which has helped to stabilize attrition over time.

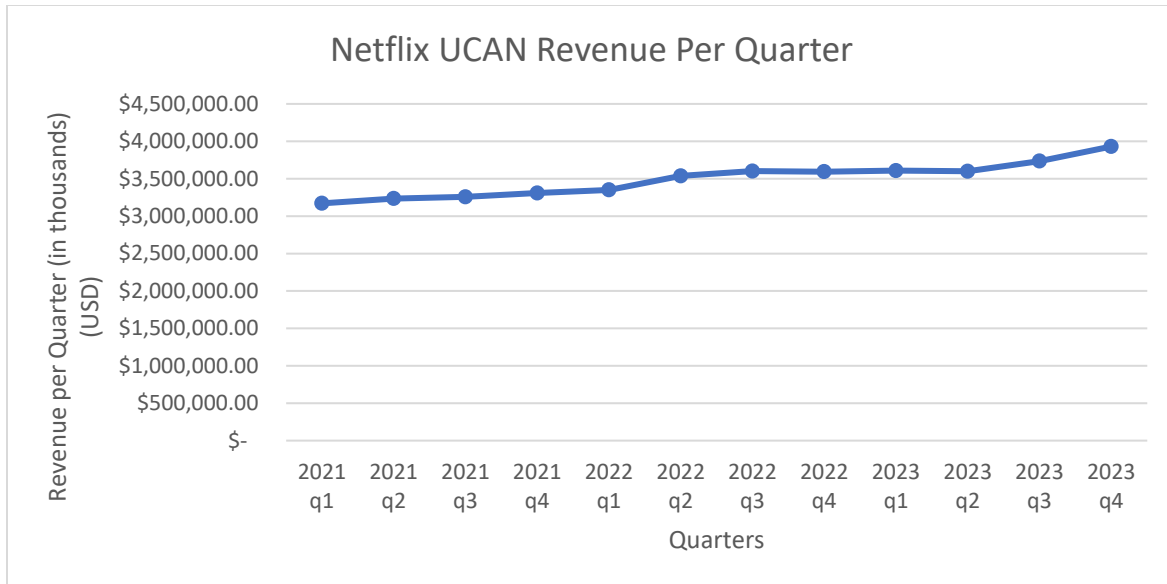


Figure 4 (based on 2023 q4 financials)

Revenue Growth Based

Netflix's revenue in the UCAN region grew consistently alongside the price increases, driven by higher subscription fees and growing membership numbers. By Q4 2023, UCAN's revenue reached nearly \$14.87 billion, up from \$6.66 billion in Q4 2017, highlighting the effectiveness of its pricing and content strategies.

Spotify (Freemium Model)

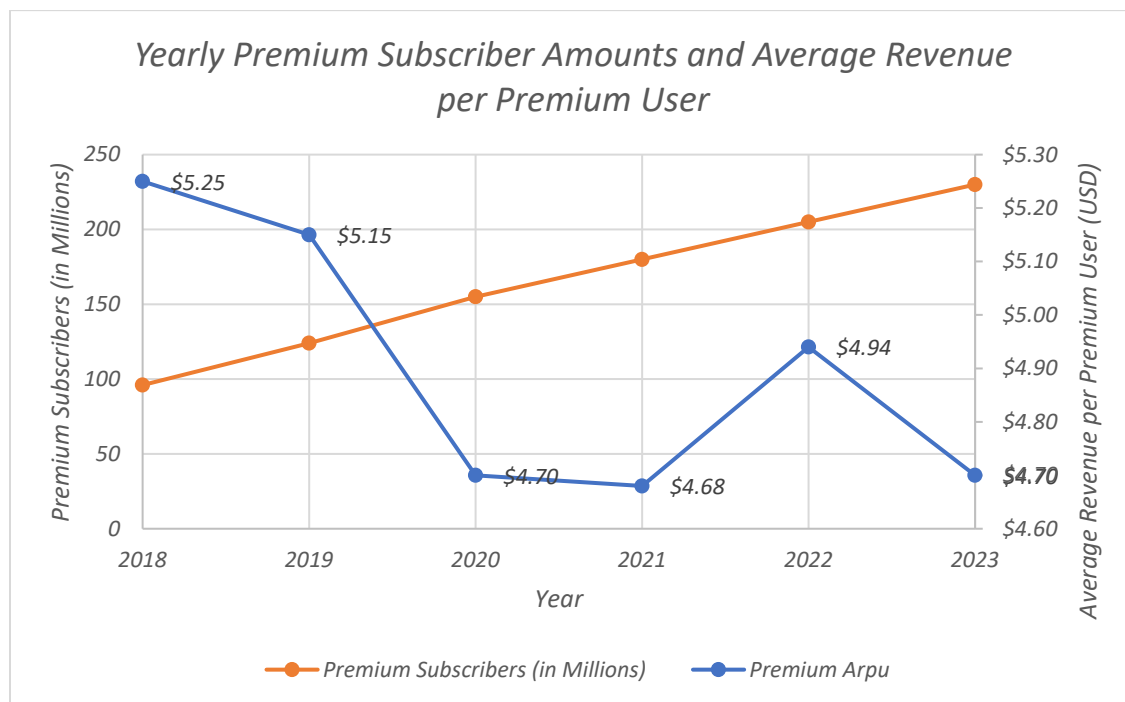


Figure 5. Based on 2020 q4 and 2023 q4 financials

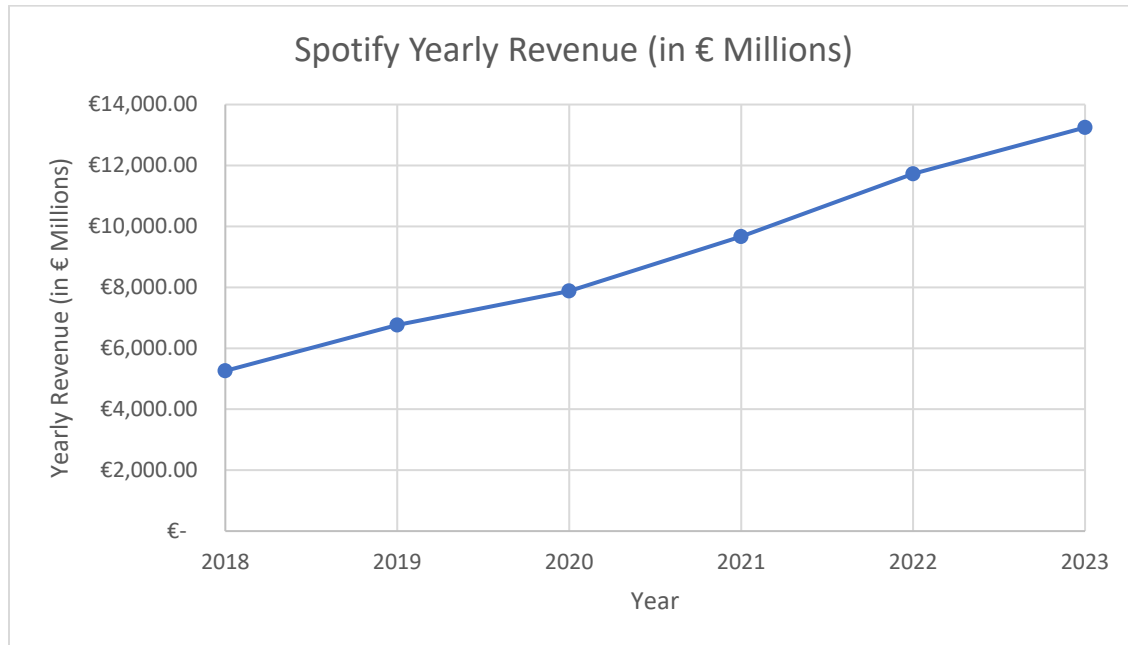


Figure 6. Based on 2020 q4 and 2023 q4 financials

Pricing and Subscriber Growth

According to The Verge, Spotify increased its premium subscription prices in April 2021, raising the individual plan in the U.S. from \$9.99 to \$10.99. Unlike Netflix, Spotify has relied heavily on subscriber growth to drive revenue, with premium subscribers growing from 180 million in 2021 to 230 million in 2023.

ARPU Trends and Revenue Growth

Spotify's Average Revenue Per User (ARPU) was at an all-time high of \$5.25 in 2018 and decreased steadily before increasing slightly after the price hike (from \$4.68 in 2021 to \$4.94 in 2022), it decreased to \$4.70 in 2023. This decrease in ARPU did not hinder overall revenue growth, as the increase in users more than compensated for the lower ARPU. Spotify's annual revenue grew from €52.6 billion in 2018 to €13.25 billion in 2023. This growth highlights the success of Spotify's freemium model, which drives subscriber numbers and revenue, even when ARPU decreases.

Freemium Model

Spotify's freemium model remains a crucial driver of its user base, allowing the platform to attract and gradually convert free users into paying subscribers. This model has enabled Spotify to sustain high growth rates even as it navigates price increases.

Rationale Behind Price Increases

The goal of Spotify's pricing policy is to maximize income while striking a balance between user acquisition. The platform gradually increases its charges since it understands that keeping users interested requires its freemium business strategy and large content library. Like Netflix's content-driven pricing model, Spotify assures sustained revenue growth without large churn spikes by progressively raising fees while growing its user base.

Conclusion

The findings underscore the delicate balance that subscription-based media companies must maintain between pricing, customer satisfaction, and revenue growth. Netflix and Spotify have both employed price increases as a strategic lever to boost revenue, but their approaches and outcomes have differed:

Netflix has leaned on its extensive content library and original programming to justify price increases, accepting some customer churn as a trade-off for higher ARPU. This strategy has paid off in revenue growth, despite occasional increases in churn rates.

Spotify has taken a more measured approach, using a combination of modest price increases and the free-mium model to sustain subscriber growth while gradually enhancing ARPU. This strategy has allowed Spotify to maintain a strong user base, albeit with more conservative revenue gains compared to Netflix.

Overall, the success of these strategies hinges on the companies' ability to deliver perceived value that justifies the subscription costs. Future pricing strategies must continue to be informed by consumer sensitivity to price changes, competitive dynamics, and the evolving landscape of digital media consumption.

Limitations

Limitations due to limited data available to the public or data breakdowns halted

Acknowledgments

I would like to thank my advisor for his valuable insights and teaching not only on the topic but how to research and perform analyses on the media industry.

References

- Statista. (2023). Video-on-Demand - Worldwide | Statista Market Forecast. Statista.
<https://www.statista.com/outlook/dmo/digital-media/video-on-demand/worldwide>
- Spotify. (2024, February 6). Spotify — Financials. Spotify.com. <https://investors.spotify.com/financials/default.aspx>
- GmbH, finanzen net. (n.d.). Euro to US-Dollar Conversion | EUR to USD Exchange Rate Calculator | Markets Insider. Markets.businessinsider.com. Retrieved August 22, 2024, from
https://markets.businessinsider.com/currency-converter/euro_united-states-dollar
- Munkachy, A. (2019, June 21). The Complete History of Netflix Price Hikes - From 2007 to 2019. Flixed.
<https://flixed.io/netflix-price-hikes>
- Understanding your Spotify Engagement. (2023, February 28). Base for Music - Blog; Base for Music.
<https://blog.baseformusic.com/articles/understanding-your-spotify-engagement>
- Warren, T. (2021, April 26). Spotify is raising prices for lots of its plans. The Verge.
<https://www.theverge.com/2021/4/26/22403813/spotify-price-increase-subscriptions-2021>
- Farris, B. (2021, February 20). Tiered Pricing – Pros and Cons and How to Implement It. Anchor Advisors.
<https://anchoradvisors.com/tiered-pricing-pros-and-cons-and-how-to-implement-it/>
- Segal, T. (2024, June 11). Freemium: Definition, Examples, and Pros & Cons for Business (D. Kindess & Y. Perez, Eds.). Investopedia.
<https://www.investopedia.com/terms/f/freemium.asp#:~:text=Companies%20can%20easily%20acquire%20potential%20users%20and%20collect>

Pereira, D. (2023, June 22). Netflix Business Model. Business Model Analyst.
<https://businessmodelanalyst.com/netflix-business-model/>
Netflix. (2024, January 23). Netflix - Financials - Financial Statements. Ir.netflix.net.
<https://ir.netflix.net/financials/financial-statements/default.aspx>
Netflix. (2024b, January 23). Netflix - Financials - Quarterly Earnings. Ir.netflix.net.
<https://ir.netflix.net/financials/quarterly-earnings/default.aspx>