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Beyond products

Paving the way to Everything-as-a-Service

Contents

Introduction

A shift from one-off sales to recurring revenue streams based on equipment usage or outputs has been common in some industries for more than a decade. Notable examples include Netflix and Spotify subscription-based offerings, both in the consumer space. Telecommunications companies have also helped set the standard when it comes to subscription-based models – historically, for example, via the provision of mobile phone plans and more recently with streaming service plans. While subscription-based models have reached high maturity levels in certain parts of industries like media and entertainment, they are still growing and evolving in others, offering opportunities for innovation and expansion across sectors.

The gradual shift towards Everything-as-a-Service (XaaS), or Equipment-as-a-Service (EaaS), if we are referring to specific asset industries, has been fuelled in part by changes in customer demand, recent and rapid technological advances, and interest from providers in exploring beyond pure asset sales to improve their margins. There has been increasing interest in these business models and various levels of success with adoption.

Two notable examples with high potential are the MedTech and manufacturing sectors. MedTech companies are at the interface between patients and health care providers, enabling them to shape the next level of connected care. Many are already looking beyond the traditional sales model by renting or leasing their products to health care institutions, reinforcing their pivotal role in delivering health outcomes. Manufacturing sees EaaS models as a promising way to provide customer-centric, outcome-based service solutions, optimising the overall effectiveness of equipment and contributing to a more circular economy.

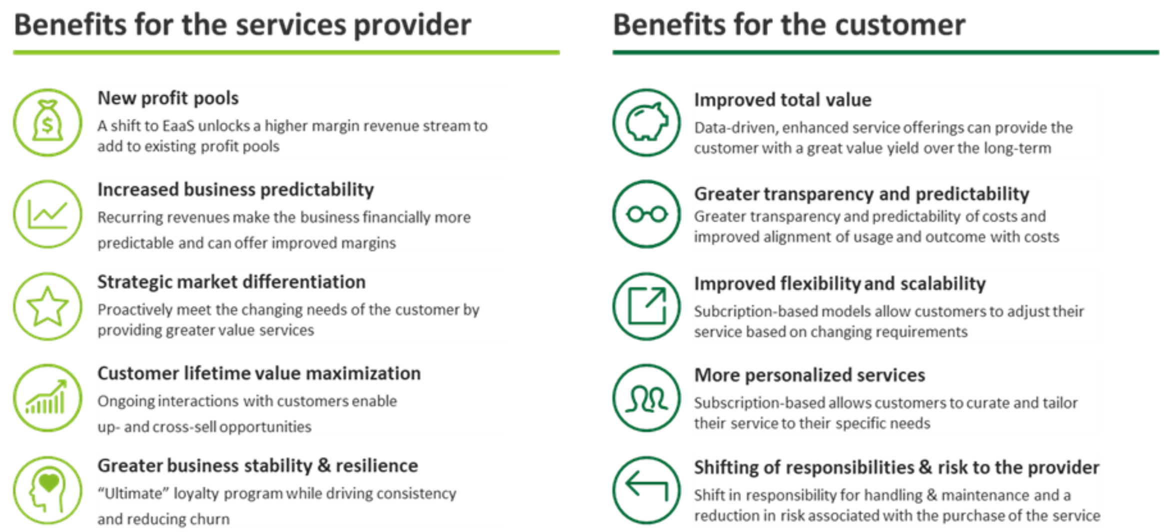
While there are ripe opportunities in these industries they do not come without challenges. But, as an increasing proportion of their leading competitors adopt subscription models, organisations need to understand what subscription models involve and offer, whether adoption makes sense for them or not, and what would be needed to adopt them.

This report aims to inform those considering a transformation journey to implement subscription-based offerings. We will specifically address the following questions:

1. Why should your organisation consider adopting subscription-based models?
2. What are subscription-based models and how do they differ from traditional business models?
3. What are some key transformation challenges you should be aware of?

Why consider adopting subscription-based models?

The shift to subscription-based models offers significant benefits for both the service provider and the customer, summarised in the diagram below.



Evolving market trends, increasing customer demand, and technological advances are creating a fundamental shift in how leading executives across industries are thinking about their business models. New business models are enabled by the wealth of opportunities created by the Internet of Things (IoT) and the possibility of acceleration by leveraging GenAI, giving providers deeper understanding of consumer behaviour. This, in combination with the promise shown by flexible consumption models, points to the enormous potential of subscriptions-based business models.

But why now? In industries with more mature subscription-based models (for example, streaming), competition is intensifying, limiting the room for growth. Hence, there is an advantage for early movers. The sooner businesses find a way to monetise their customer-centric, flexible consumption models, the bigger the growth opportunity.

Industry spotlight: MedTech

MedTech is well positioned to benefit from XaaS. The current patient profile is changing, with patients becoming more active in their healthcare journey. They are focusing on wellness and prevention and are seeking customised solutions for their specific needs, with greater ownership of their health data. This shift also means patients are willing to pay more for health services that offer such solutions. Deploying subscription-based models allows organisations to address these needs through more personalised solutions and through greater utilisation of data.

As with other industries, this industry needs to respond to increasing margin and cost management pressures. A shift from capital expenditures (CapEx) to operational expenditures (OpEx) provides greater flexibility. Service-based models can help provide data-rich services and generate higher quality, value-based care that patients are willing to pay for.

In addition, technological advances are permitting greater product innovation, and patient demands are shifting towards a more digitalised healthcare experience. Products and services that leverage cloud-based systems, GenAI, and automation can be turned into wider offerings that utilise subscription-based models to create real-time, data-driven ecosystems that follow the patient journey. Combining the latest technologies with subscription-based models presents a huge opportunity for creating enhanced offerings for patients.

Industry spotlight: Manufacturing

Manufacturing is responding to changing customer demands and organisations that have already adopted new monetisation strategies such as EaaS are growing significantly faster than traditional companies.

Customers are increasingly aware of EaaS and the benefits it can bring. Many manufacturing clients welcome the shift from CapEx to OpEx and the flexibility of new as-a-service models.

Technological advances, including those related to IoT, have enabled EaaS to become an even more attractive proposition. Equipment manufacturers providing IoT-enabled machinery can utilise these technologies to monitor usage and performance data more accurately, enabling the provider to charge more accurately and curate their offerings. Further product innovation is also creating more opportunity for manufacturers to provide new services, further driving the potential of the subscription-based model.

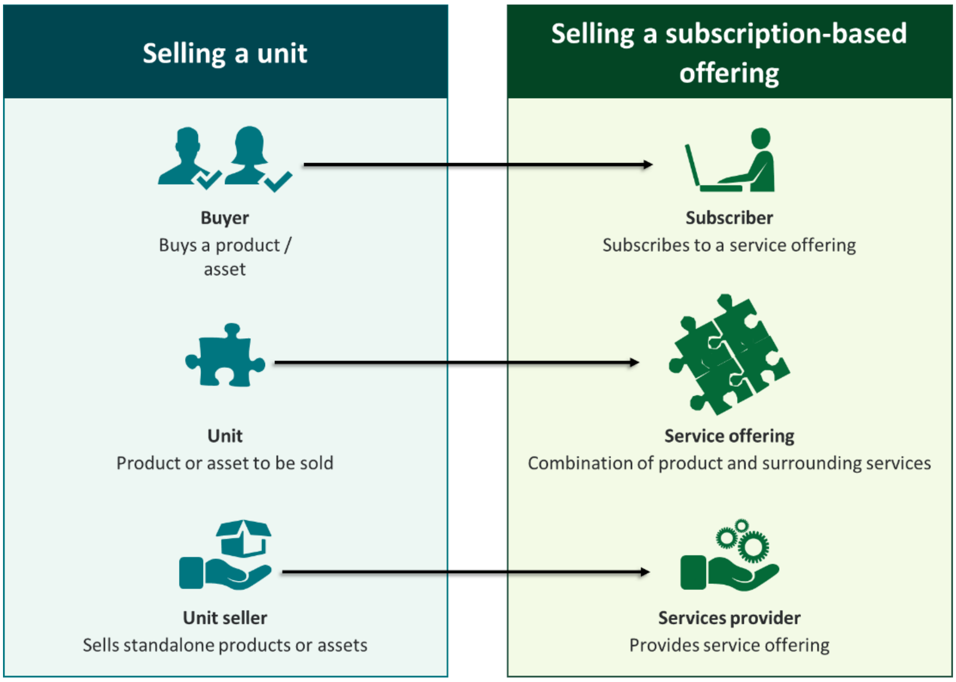
Manufacturers have an opportunity to increase market share at a time of shrinking asset margins. As this leads to greater aftersales business, manufacturers who can offer a service beyond traditional pure asset sales can react and increase their market share.

What are subscription-based models and how do they differ from traditional business models?

The first step towards adoption is to consider what a subscription-based offering would look like for your organisation and why you should consider adopting it.

XaaS refers to the bundling of products (such as hardware, devices, equipment, consumables) and/or software with value-added services. While there is no officially agreed definition of XaaS, services may include installation infrastructure, ongoing maintenance and upgrades, training support, analytics capability, customer services provision, and disposal and replacement of products as required. XaaS employs recurring payment structures with either a fixed subscription fee or a flexible consumption model where the fee is adjustable based on usage level or outcome. This differs significantly from traditional business models, which are largely based on customers paying a one-off fee to acquire a given asset or product.

The graphic below illustrates the shift from selling a unit to selling a subscription-based offering.



To approach the transformation from a traditional to a subscription-based business model, two key questions can be asked:

- What is going to be sold?
- How should it be sold?

What to sell

What to sell depends on leveraging technological advances and developing a service proposition to evolve the traditional business model of selling a machine or device as the end outcome. This is often seen as the first and least risky step on a business model transformation. Technology enablement is typically met with less resistance internally.

The goal of technology enablement is to equip the organisation with new services that can generate additional revenue streams without requiring significant changes to existing core structures. When implemented correctly, new technology can cater to existing customers while also attracting new customers who are currently being served by competitors. However, motivating teams to pursue new services and gaining support from the business can be challenging. Therefore, it is crucial to have a solid vision in place that captures how the addition of services contributes to the larger organisational goal of creating a competitive market advantage and driving revenue growth.

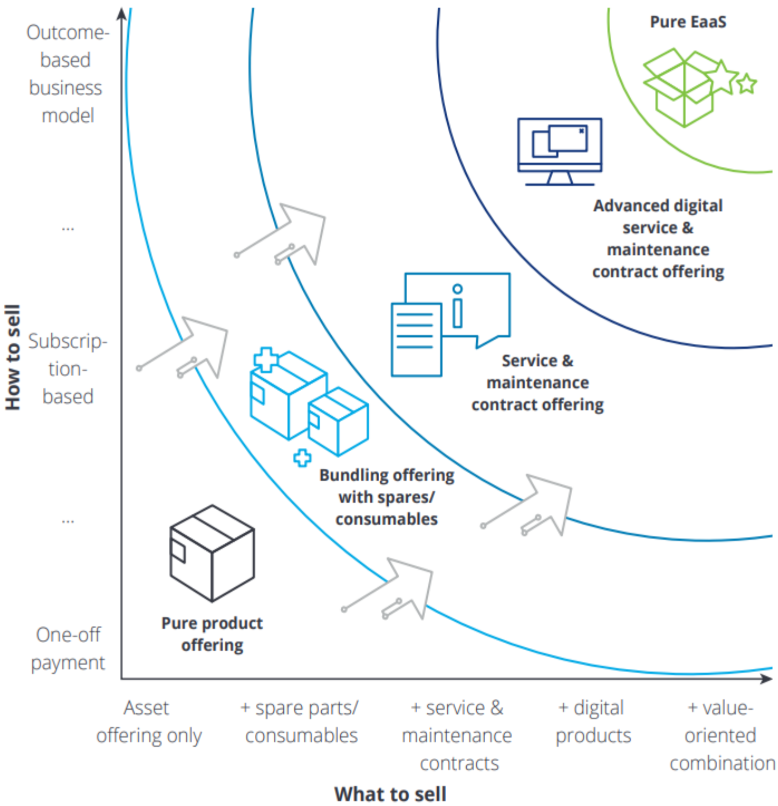
How to sell

Firms must consider how a revised offering based on a subscription-based model may better meet customers' needs than the traditional model of one-off transactions.

A subscription-based model makes it possible to revitalise certain products or product lines that have been underperforming. These products can be sold as part of a bundle of services or offerings to address a specific, often underserved, client segment.

Moving towards a subscription-based model also entails a commitment to better understanding customer needs and simplifying the process for the customer. For example, a recurring subscription fee can replace a rental or licensing fee for a device, along with a separate one-off fee for yearly maintenance. Offering a "scaled back" or "lower economy" version of a product may prove to be more suitable for certain customers' needs, leading to higher customer satisfaction. The organisation can become more customer-centric using this model.

Service development phases



Moving towards Everything-as-a-Service

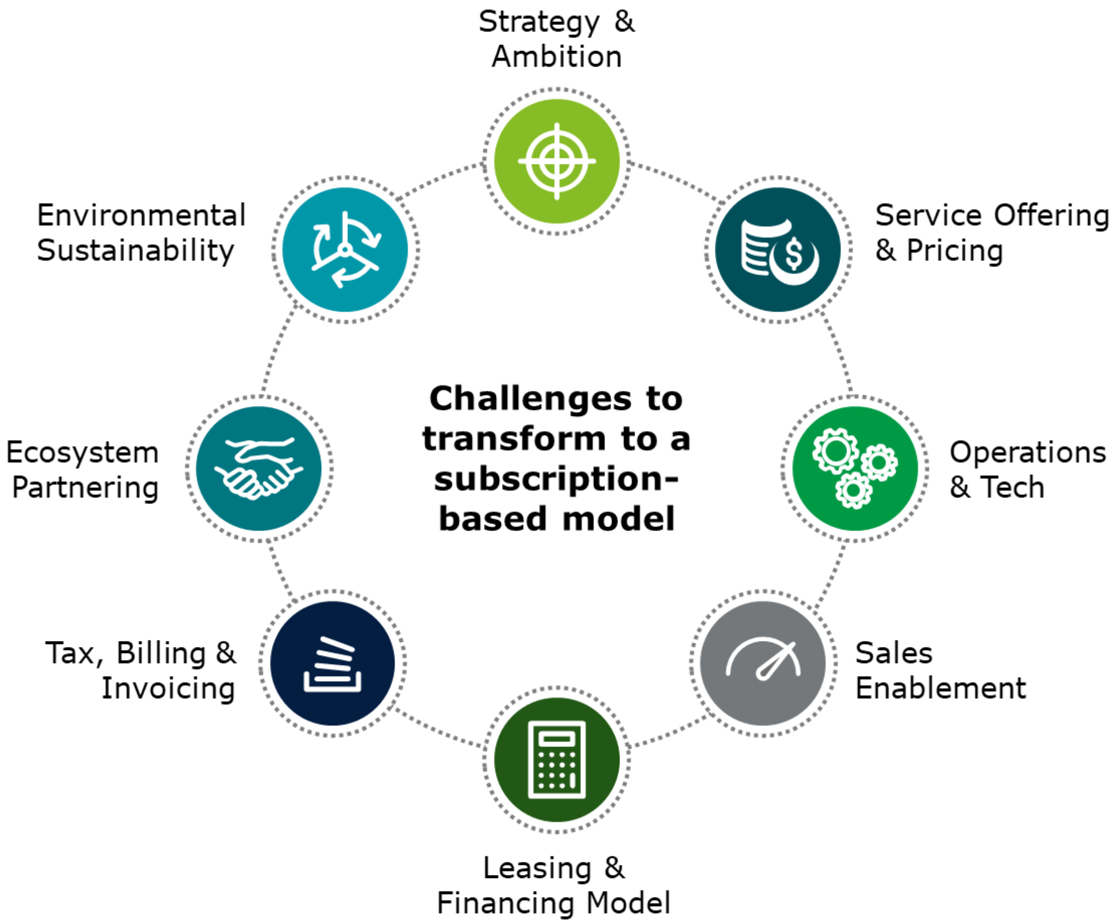
Organisations typically progress through the transformation journey described above in incremental steps, gradually building towards a complete subscription-based model. This approach helps minimise disruption to the organisation and mitigates the risks associated with the transition.

It may not always be beneficial to compete directly with the organisation's current models of selling goods or assets. In many cases, it is important to consider any new business model within the constraints of an existing model. The transformation can be carried out in a flexible and agile manner, allowing for parallel delivery of existing product offerings to ensure business continuity. Technological advances can be planned and implemented at an early stage to establish the foundations for the full model. Organisations often start by launching a pilot XaaS model with the aim of adapting and scaling as they progress. As the organization gains experience with new XaaS models, its capabilities will also need to evolve gradually.

When it comes to existing product offerings, rather than trying to fit them into the new XaaS pattern, the organisation should assess whether it makes sense to retain some of these under a traditional model, even at an initial stage, thus enabling a progressive transition to XaaS from the currently established and tested model. Adopting a more holistic and tailored approach to implementing the new model is likely to yield better outcomes for the organization in the long-term.

Key transformation challenges and considerations

Moving from the traditional model of one-off asset sales to a subscription-based arrangement can be challenging. We have identified key areas that organizations should consider when exploring the move towards XaaS. These are examined below.



Strategy and Ambition

Without strong strategic direction, C-level support, internal alignment, and a clear ambition for the transformation, challenges are likely to arise during and after the adoption of subscription-based offerings as new business models. It is crucial to have a clear articulation of the service offer strategy and a well-defined implementation roadmap, ensuring alignment with the overall organisational strategy.

Integrated strategy planning and coordination, considering the interdependencies between different stakeholder groups (including core business, customer-facing, and enabling services), are essential for a successful transformation. Establishing a strong project management capability and change management framework from the initial stages of the adoption process will greatly increase the chances of success.

Key questions to consider:

- What are your ultimate objectives, including wider strategic, innovation, entrepreneurial, financial, and sustainability goals?
- What is your target playing field in geography, target customer segments and solutions, assets, or products to be adopted?
- Who will be the executive sponsor of the initiative, and how will they ensure alignment across the business to mobilise and connect all the moving parts?

Service Offering and Pricing

The degree of change that new subscription-based models provoke is not only high for the organisation, but also for the customer. A more dynamic approach to customer segmentation, based on, for example, behavioural patterns can help identify the most relevant customer types or clusters to target. Organisations should not be afraid of testing and iterating their assumptions with key target customers to finetune value propositions. This also makes it possible to build deep relationships with customers.

Pricing decisions will be key. More traditional pricing approaches, like cost-based pricing, will not work. As-a-service players need to adopt value-based pricing models. This makes it necessary to understand the value perceived by customers and design the right packages and bundles of features. These packages can be persona-based, follow a modular build around customer workflows, or be categorised based on the degree and number of features they offer (for example, "gold" versus "silver" packages) or by usage (pay-per-use).

The way payment terms are organised, such as the billing frequency or renewal terms, offers another way to tailor the offer to customer preferences. It is important to carefully consider how different features are allocated in distinct packages and prioritise which features and functionality will achieve maximum customer satisfaction, a unique position in the market, and margin enhancement. The customer needs to have a clear understanding of what they are purchasing and the underlying value of the physical asset combined with the support services offered.

Key questions to consider:

- What should your updated customer segmentation look like based on the planned changes in offering?
- How should you bundle and package your products and services to best serve your defined segments?
- What will your pricing look like for the new offering (in comparison to your existing offering and competitors' offerings) and how will this impact your margins under a subscription-based model?

Operations and Tech

As the new offering becomes established there will be changes to the organisation's operating model and underlying processes. Customer journeys will need to reflect the purchasing of a services bundle offering rather than a single product. Resources, including human resources and equipment, will need to be effectively allocated across the components of the offering. Introducing automation will be critical, especially when offering flexible consumption models and scaling. Automation helps ensure efficient and smooth operations, so that the benefits of the new offering can be realised.

As the model matures, changes to the operating model and underlying process workflows will be further enabled by technological disruption. Technology providers offer software solutions to enable and manage the subscription-based model and its underlying components. Analytics and data mining capabilities are often included in the solution, allowing for the gathering of data on service usage to derive insights that help customise services to customers' specific needs.

Customers can expect to receive different technological components as part of the package they purchase. This may include the device or item being sold, along with accompanying software for item management and data gathering and analysis. Integrating new technology components into the organisation's existing technology stack, as well as the customer's technology environment, can be complex.

Key questions to consider:

- How will the new model affect existing processes and the overall operating model?
- What technology components need to be considered as part of the transformation?
- How will incoming technology be integrated into the current technology stack and managed going forward?

Sales Enablement

The change to the salesforce will be significant, and it is crucial to get this aspect right from the beginning. The salesforce needs to be able to clearly articulate the benefits of the offering while confidently addressing any questions or concerns. It should be able to educate new and old customers, emphasising that subscription models go beyond just the product itself and encompass intangible goods. A strong sales incentivisation model is necessary to ensure successful adoption and greater market penetration.

Other roles will also be affected. Organisations with more mature subscription-based offerings often establish customer success managers whose role is to track the performance of the offering over time and across customer segments and geographies. Customer service staff may also require training to effectively address incoming customer inquiries and complaints related to the offering.

It is important to adopt a Customer Lifetime Value perspective rather than focusing solely on single sales. The salesforce and customer service teams should be able to navigate different buying groups, some of which may have a stronger affinity for the traditional model and identify cross-selling and upselling opportunities based on actual usage patterns. Organisations need to determine the best setup to help customers realise value from the offered solutions, while increasing customer loyalty and minimising churn.

For both MedTech and manufacturers, sales through partners are often significant. How to approach your partner network can easily become a critical part of the overall transformation. Current partners need to be assessed to understand to what degree they will work well in the new business model, or whether it might be more beneficial to select new partners.

Key questions to consider:

- How should your sales organisation be structured to effectively serve the new portfolio of products and services?
- What incentive scheme needs to be adopted for your salesforce to support the organisation's ambitions for the new offering?
- What will my partner sales channel look like under the new offering and are my partners ready to adopt the underlying philosophy of customer success?

Leasing and Financing Model

As-a-service business models pose their own financing challenges. While the target of predictable recurring revenue streams is highly attractive, the impact during the transitioning phase is disruptive. Together with the design and implementation of a new set of KPIs to measure success, funding is a key challenge from the CFO's perspective. As an organisation moves towards subscription-based and outcome-based models the finance function needs to be ready to close upfront investment and bridge-finance cashflow gaps until sufficient recurring payments have been received to compensate for the investments made. The CFO also needs to assess the share of assets it is comfortable keeping on its own balance sheet and the share that would need to be transferred to other entities.

While the initial steps of asset financing for the new business model is generally supported by regular corporate funding to stay independent and flexible, it is also important for the CFO to formulate a strategic forecast of the transformation to understand when external financing sources need to be tapped. Banks and asset-based financing can be used while the new as-a-service model begins to scale. Once new geographies and additional services are targeted, new financing partners should be added to enable further growth. As the new business matures and the organisation gains confidence, CFOs will want to evaluate the options to internalise financing again through fully owned financing entities or selected partners through special purpose vehicles.

The finance function plays a critical role in an organisation's transformation to an as-a-service player. It is important to explore the key questions early in the journey to be able to forecast funding phases and requirements and understand potential partner and operational readiness to support the transformation.

Key questions to consider:

- What revenue gap is expected during the transition from an asset-based sales model to a recurring-revenue model?
- Where do you see your funding thresholds when it comes to asset financing and who could be your financing partners?
- What new set of KPIs will optimally support your transformation?

Tax, Billing, and Invoicing

Issuing an invoice encompassing all provisioned services can become challenging in new subscription business models, especially given the increased flexibility customers have. The rapid growth in transaction volume adds to the complexity for finance and operations teams. Choosing the right moment to secure adequate technological support, such as specialised technology for subscription billing, is critical. At the latest when the organisation is looking to scale its new supplies in the market, the adoption of automated and flexible billing solutions becomes key. Involving finance, operations, and accounting teams early on is important to address invoicing and revenue recognition while optimising and automating corresponding processes.

From a tax perspective, new subscription-based offerings will be treated differently from traditional asset sales. VAT (Value Added Tax and/or similar) and customs duties, particularly in relation to industrial goods being offered as a service, need to be considered. Tax obligations should be addressed for all parties involved in the provision of the offering, and staying tax compliant may require new expertise and processes. Implementing the new offering fiscally may involve onboarding external partners to provide a subset of services while ensuring tax compliance. Understanding the underlying transactions and defining the distinct legal entities involved will inform transfer pricing for transactions across tax entities.

An organisation's ability to fulfil tax obligations in the new model will evolve over time. Starting with a pilot offering, involving legal entities within one geography can help manage tax obligations. As the offering grows and expands into different customer segments, there may be an opportunity to scale across geographies. Withholding taxes can vary from country to country, adding complexity to tax compliance and potentially affecting the pricing of the offering.

Key questions to consider:

- Is technology required to implement billing and invoicing processes, considering the expected increase in transaction volume and complexity?
- How to ensure VAT (similar) compliance across different market jurisdictions with transactional design, and how to limit compliance costs?
- How will services be treated by customs authorities from a customs valuation perspective and how should transfer pricing be set up?

Ecosystem Partnering

Organisations offering subscription-based services need to assess whether they can deliver the services independently or if they require alliance partners for support. For example, financing partners such as banks or financial institutions may be considered to help fund the assets that now sit on the organisation's balance sheet (see section on Leasing and Financing model). Partnering can help transfer risk and provide specialised solutions that enhance the overall service offering, driving greater value for the customer.

Providers should be able to tailor the subscription model to the customer's needs at the partner level, rather than offering a generic combination of services. It is important to clearly define the responsibilities of vendors. Customers prefer a single point of contact for enquiries and support, rather than interacting with multiple parties.

Selecting the right partners and smooth integration of partner processes into the organisation's workflows are crucial. Partners should operate at the same quality and delivery standard as the offering provider and demonstrate a thorough understanding of the offerings available to customers. Information shared with vendors should be handled securely through an integrated technology platform embedded within the offering.

Key questions to consider:

- Which services of the subscription-based offering should be provided in-house versus through a third-party vendor?
- Which existing third-party vendors offer capabilities and services of sufficient quality to partner with?
- For which steps in the service offering do you need to look for new partners in the ecosystem?

Environmental Sustainability

Under a subscription-based model the provider retains ownership of the asset instead of transferring ownership to the customer. This means that the provider becomes responsible for the maintenance, upkeep, and longevity of machines and devices. Clear ownership incentivises the service provider to optimise an asset's uptime and maintenance in a way that reduces waste and sub-optimal deployment. It also drives efficient resource allocation, allowing the service provider to use assets across multiple service contracts and customers, enhancing overall asset utilisation.

The responsibility to decommission, refurbish, and recycle assets acts for many organisations as an entry to the circular economy. Service providers have full transparency and control over an asset's history and usage. Customer concerns regarding the quality of refurbished parts and assets are tackled by outcome-oriented service provision. Hence, barriers to use of refurbished assets and spare parts are significantly reduced. Similarly, the end-of-lifecycle management also falls to the service provider who is best positioned to appropriately recycle and dispose of assets, spare parts, and components to minimise the environmental impact.

Even if there is a lack of a universally accepted set of standardised KPIs for the circular economy, as-a-service models offer a wide range of opportunities to contribute positively. Organisations considering the adoption of subscription-based offerings should make their service's contribution part of the organisation's wider sustainability strategy and goals.

Key questions to consider:

- How does your new offering fit into your overall sustainability strategy and how do you want the new service offering to contribute?
- What new capabilities do you need in order measure and monitor the new service's impact on environmental sustainability?
- How can you combine environmentally sustainable methods with meeting your specific customers' needs? Which elements can provide additional customer value?

Bringing it all together

XaaS models have proven to be successful in industries such as telecommunications and have enormous potential in MedTech and manufacturing. Adopting subscription-based business models is critical to meeting evolving customer expectations, leveraging technological advances, and maintaining a competitive edge in the market.

The successful adoption of subscription-based service offerings requires a comprehensive approach that needs to consider various components, ranging from a clear strategy and vision to operating model changes, technology choices, financing, tax, and sustainability considerations.

Understanding the changes required for a successful transformation, as well as the cultural shifts needed to gain internal, customer and investor buy-in, is important. These questions should be asked first to form an integrated perspective for your organization.

Deloitte are here to discuss any questions you may have and to explore how as-a-service models might be applied in your organisation. We look forward to supporting you on your XaaS journey.

Let's talk

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