

Applying Options and Subscriptions to Consumer Marketing

by Steffen Tichatschke

Riva settles into her comfy armchair for the evening. It has been a hectic day at the office, and when she came home, it was homework and preparing dinner and school lunches for her two children, Amanda and Jacob. Her husband was away on business, which always doubles her household work. Now, with the kids in bed, it was finally “her time”. She logs on to NetMoments from her netbook computer and reviews the current offerings. There is a business article on how to market travel packages to retired professionals, a nationwide newspaper published the latest statistics on most popular travel destinations, and there are two science videos that had been recommended by her son’s teacher. Ever since she subscribed to NetMoments, she has been looking forward to finding out what’s new. Newly published material arrives nearly every day. It has made a big difference in her job as a Marketing Executive at a leading travel services company. At the same time it has allowed her to guide her children’s school work with relevant publications. She sends the science videos to the Home Media Center with an attached note for Jacob, and enjoys a nice cup of her favorite tea while browsing through the travel article.

Riva’s experience is commonplace today in developed countries. Everyone attempts to balance the demands and opportunities of workplace and family. How can two important marketing concepts, options and subscriptions, help people in meeting their own goals? This article will describe some of the basic concepts, and subsequently illustrate their application with examples

in the travel industry, in automobile leasing and in real estate sales.

Subscriptions and Options

Subscriptions are well understood and accepted by consumers. Examples are newspaper and magazine subscriptions, subscribing to cable or satellite TV, or subscribing to specialized information services, for instance on health, legal or business issues. In most cases the subscriber pays a fixed price for a certain period of time, known as the subscription period, in exchange for the delivery of news, entertainment, or other information. A somewhat more extended concept of subscription is the membership in discount wholesale and retail clubs. By paying a membership fee, the consumer subscribes to the right to purchase discounted items at a specific set of stores. A common factor in subscription sales is the perceived value of the subscription offerings. The consumer will carefully evaluate whether it is worth subscribing to a particular magazine, or if the pricing at a discounter is indeed consistently lower than at other retailers for the same item at comparable quality.

Options, on the other hand, are somewhat lesser known and seldom utilized in consumer marketing. Financial professionals and employees of companies utilizing stock options in their compensation packages are familiar with the concept of equity options.

An option gives the holder the right to purchase a particular good or service at a set price, also known as the strike price or conversion price, for a defined

period of time. The point in time when his right expires is known as the option's expiration date. While there are other types of options, especially in finance, for the purposes of this article, the author will exclusively focus on options that carry a purchase right at a fixed price over a fixed period of time.

This purchase right can either be conveyed to the holder or bought by the holder. Employee stock options are granted to the holder by the company, giving the employee the right to purchase company stock over a specific timeframe at a specific price. An option may also be bought by the holder by paying the price of the option, also known as the option premium. Such a purchased option carries identical rights, i.e. in this case the right to purchase the stock at a given price and timeframe.

This article would like to explore in more detail the scenario of purchasing an option when applied to consumer goods and services.

Holidays Are Us

Holidays Are Us is a global travel company with hotels in desirable locations and a full service airline providing transportation to its hotels for clients. Over many years it has built its hotel portfolio to consist of properties that are near entertainment parks and waterfronts in order to cater to families with children, complemented by a set of smaller and quieter destination properties near National Parks and Cultural Points of Interest for the experienced traveler.

Business had been growing really well for several decades. However, now the company is struggling with decreased demand during the recent slowdown. Financial difficulties are exacerbated by its fixed inventory of hotel rooms and aircraft leases, which result in a certain fixed cost, making it easy to plan with during normal times, but somewhat inflexible when demand decreases. Vacation packages are sold through

a number of travel agents, who advertise them in the print and television media and on various websites. Holidays Are Us has tried to stimulate demand by offering a 20% discount on travel packages that include both hotel and airfare. While overall demand has not improved, the Company believes that the discounting has prevented a further deterioration in its business. The program has been especially popular with repeat customers who value the Company's travel offerings and are taking advantage of the reduced price. How can options and subscriptions help Holidays Are Us weather the downturn and emerge stronger when business conditions will improve?

The Company decides to launch two new programs, offering the TravelMore program to its experienced traveler segment and targeting business travelers with its TravelWithUs program.

The TravelMore program offers the client an option to purchase a discounted travel package at a date in the near future. These purchase options are designed based on content of the travel package, destination and season, thereby matching the Company's existing pricing philosophy. The traveler can purchase an option now that guarantees her delivery of a particular content (hotel, airfare, or both) during a particular timeframe in the future, for instance at Christmas. Pricing is very important in order for the consumer to quickly understand the perceived value. The transaction consists of two parts, the purchase of the option and the subsequent purchase of the goods or services at the set price. In our example, a low option price of 5% of the list price can guarantee the 20% discounted package rate, which the traveler pays at an agreed upon time before the travel date.

Business travelers had previously been underserved by Holidays Are Us, even though some of its family destinations are in major metropolitan areas. In order

to attract this segment, the Company decides to offer two classes of subscriptions through its TravelWithUs program. The first subscription class gives travelers the right to stay a specific number of nights per calendar quarter at the Company's hotel properties. The premier class adds certain business services, such as access to meeting rooms, teleconference and video conferencing, and concierge services for event tickets to enable the business traveler to entertain clients. Both subscription classes have a fixed price that is configured based on the number of nights included.

Holidays Are Us realizes two immediate benefits from the TravelMore and TravelWithUs programs. Firstly, it presents an attractive offering to its customers, enticing them with value pricing and bundling of services. Secondly, both programs improve the Company's forecasting of future demand, allowing it to plan its internal resource allocation based on demand that has been "pre-procured" by travelers through either an option purchase or a subscription purchase.

The benefit to the customer is also planning certainty, being able to procure services at a set price for future utilization. Customers need to be able to rely on the fact that the provider of goods or services will be able to fulfill the contract.

AutoShow Leasing

AutoShow Leasing is a nationwide automobile leasing company. It offers attractive rates on the most popular, environmentally friendly vehicles and has procured maintenance contracts for the lease duration with specialized dealerships. When an existing lease expires, most customers are looking to either obtain a new lease on an equivalent vehicle, or to lease a more expensive model with an expanded feature set.

In response to requests from its business customers, who would like more planning certainty during the lease renewal period, AutoShow started offering

10-year subscriptions on vehicle classes. It enables the customer to swap his current model for a new model three times during the subscription period.

The Company also innovated in offering upgrades. Customers in any lease structure, who know that they want to upgrade their vehicle class at the end of their current lease term, can purchase an upgrade option based on the desired vehicle class. In exchange for payment of the option premium, the buyer obtains the right to lease the upgraded vehicle class at a set monthly rate starting during a specified timeframe in the future.

The benefits for AutoShow and its customers are in improved planning certainty of vehicle leasing demand and lease pricing. Like with any option contracts, in order to ensure customer satisfaction, it is important to have the contract deliverables specified to a substantial degree. In this example of vehicle classes, the deliverables specification might include a range of engine performance, number of passengers seated, fuel consumption, choice of colors and interior features.

Real Estate Services

The purchase of a new home is a major event in most people's lives. It is also often their biggest purchase by dollar value. A lot of resources, such as time, advertising dollars and energy are expended by all parties involved, with the real estate agents coordinating most aspects of the transaction. The closing of the transaction is a major event for both buyer and seller, with the buyer nearing exhaustion from all the activities to ensure that their purchase was well placed. The last thing most buyers are immediately prepared to do is a remodel to address the inevitable cosmetic issues, or to convert and upgrade the property to their liking and specifications. Such projects range from built-in appliances over wall and floor coverings, to roofing, pool and spa, and energy-saving heating and air conditioning equipment. In some cases

structural enforcements or additions are desired. Buyers from outside of the area face an additional complexity in not having a network of trusted contractors. Most real estate agents will recommend contractors in order to ease this task somewhat. However, the new owner still has to go through the process of obtaining competitive project bids.

Imagine the new owners being presented with a set of improvement options that is tailored to the specific home purchased. The options included in the improvement package are project bids tailored to either required improvements on the home, or typical improvement projects new home owners will take on, such as exterior and interior painting. Each project bid is specific with regard to final deliverables and the quality of utilized materials. The improvement package is being offered for a fixed price by the seller's real estate agent alongside the home sale. The buyers can make their purchase decision after full review of the options details in order to understand its perceived value.

Additionally, the buyers' real estate agent may offer her own improvement package, resulting in a situation where the new owners have the choice between two independent sources. It is conceivable that in addition to pricing a comprehensive improvement package, the new owners can choose à-la-carte their desired improvements and are also able to pick and choose individual project options from either of the realtors' improvement packages.

Benefits of this approach are home improvement planning certainty for the new owners, improved project flow and forecasting for participating contractors, and additional revenue for the real estate agents.

Summary

Options and subscriptions can be applied to create innovate consumer offerings. But haven't we recently heard that options are bad? Most of the negative

publicity for options results from stock options accounting issues, and the overuse of options and similar contracts contributing to the recent issues in the financial system. In the author's opinion, that goes to show that too much of a good thing can indeed be bad for participants. The benefits of options structures are real, and lessons learned should be followed when applying their usefulness to consumer marketing. The structured consumer offerings should be comparatively few per product or service, with easy to understand contract deliverables and pricing. Delivery of product or service must be guaranteed by the business, or alternatively internal provisions for overcompensating the customer in other ways need to be made.

Both options and subscriptions have the potential to significantly improve customer retention for businesses. This can be a major incentive for the sales force to embrace the concept. Another benefit is improved forecasting of demand at particular price points. The benefits for the consumer are in the planning certainty with regard to pricing and availability of desired goods and services. For options, an important component of the offering is the pricing of both option and subsequent contract deliverable. The combined price must result in a high perceived value by the consumer. The substantial specification of delivered goods or services is important for both options and subscriptions in order to avoid contract disputes and to ensure customer satisfaction.

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The business names in this article are fictional and only intended for illustration purposes. Similarities with existing companies, products and services are coincidental and unintended.