TDC *VISION TO MOMENTUM*

Capitalizing for
the Reimagined Subscription Model

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How does capitalization intersect with the changing subscription model?

Operating model
- Net implications for the business and its components
- Revenue dependencies

Liquidity
- Cash flow

Operating reserve
- Extra cushion for riskier model

Risk capital
- Capital to fund operating deficits while strategies mature
- Consumable capital to pilot new initiatives

Where do we see the intersections?

- Organizations report that that **tickets sales often do not meet rational, conservative targets**, which are based on renewal rate analysis.
  - Operating model can be negatively affected.
  - Available cash (liquidity) can also be negatively affected.
- Organizations **struggle to invest in strategic change** using the lens of annual budgeting.
  - Often there is no long-term investment theory (risk capital).
  - New, resource-intensive efforts are the first to be cut when trying to meet annual budget goals.
- Organizations find it even **harder to invest in approaches that depart from the subscription model**.
  - It's challenging to imagine how to support (risk capital and liquidity) a disruptive approach.

What does this imply?

- Renewal rate analysis may be too blunt an instrument.
- Short-term budgeting may not allow for the capital required to fully test change.
- Or both.

How might we look at patrons differently?

	Traditional	Updated	Rationale
Unit	Tickets	Households	Enables focus on observable buyer behavior
Segmentation	Undifferentiated ticket buyers and donors	Cohort tracking	Helps to predict financial impact of losses and acquisition
Fundraising	Separated purchasing and giving	Integrated purchasing and giving	Helps to predict sales and donations based on cohort behavior
Context	Last year v. this year	Multi-year, past and future	Keeps focus on the true magnitude of the challenge

How might we manage differently?

- **Timeframe:** thinking about expenses over a multi-year horizon puts strategies in a realistic context.
- **Capitalization strategy:** identifying dedicated capital funds to support new strategies gives them a chance to mature.

AN EXAMPLE FROM OUR PRACTICE

AN APPROACH TO EVALUATING YOUR CURRENT MODEL

An approach to evaluating your current model

1: Understand baseline trajectory

- How will current trends impact operating results and cash flow in the future?
- Will trends put pressure on sources of revenue other than ticket sales (e.g. annual donations, other earned, etc.)?

2: Test how you might strengthen the current model

- What might the revenue *and* expense impact be of strategic efforts?
- Is the net impact (scale) of your strategic effort big enough to fix the challenge in your current model?
- Will you see returns fast enough to fix the challenge in your current model?
- Might strategic efforts have additional cash flow impacts?
- How might risk capital help protect you during testing?

A case study

- A performing arts company ($15M budget) is in the midst of an artistic revival and organizational turnaround.
- They launched their turnaround three years ago with the following strategic theory:
  - Lifting the quality of the art (through production expense increases) will lead to…
  - An increase in ticket sales (through subscriptions), and…
  - An increase in contributions from a wider donor base.

The capitalization plan

- To prepare for the turnaround, the company created a four-part capitalization plan:

Operating model	• Financial projections (revenue and expense) that were tied to strategy and resulted in small annual surpluses.
Liquidity	• $1M was raised to ease cash flow; this amount was set by analyzing the size and frequency of current cash emergencies.
Operating reserve	• $1M reserve was raised to cushion the budget over the five years of strategic change.
Risk capital	• Major donors were identified to cover the four years of $1M+ deficits the company would run while their strategy matured. • $1M was raised in consumable capital for artistic choices that surpassed expense projections.

The current challenge

- After three years, the company reflected on their primary metrics and felt good about progress:
  - Reviewers, close friends of the company, and industry peers raved about the art.
  - Subscriber retention grew from 80% to 85%; number of new subscribers had stayed flat over the three years – not ideal, but certainly not bad.
  - Contributed revenue had grown.
- However, the organization didn't feel financially stable, and they couldn't consistently hit revenue targets.
- Plus, leadership was having trouble seeing what would replace the annual $1M+ in risk capital needed to close the budget.

Our initial questions

- The performing arts company asked us to help create better multiyear projections.
- To start, we asked them to reflect on their capitalization plan:

Operating model	• Artistic expenses are higher than expected to meet the level of quality the company stands for. • Subscriber retention numbers are growing, but revenue is still bumpier than predicted, and overall flat through a trend lens. • There's been no increase in the number of donors because the pipeline seems so thin, especially in the mid-level-donor range.
Liquidity	• Even though the company raised $1M for liquidity, there are still at least two serious cash crunches per year.
Operating reserve	• The $1M for five years has been spent in three years.
Risk capital	• The money raised to support new artistic choices in the future is being used now to fund unexpected gaps in core operations.

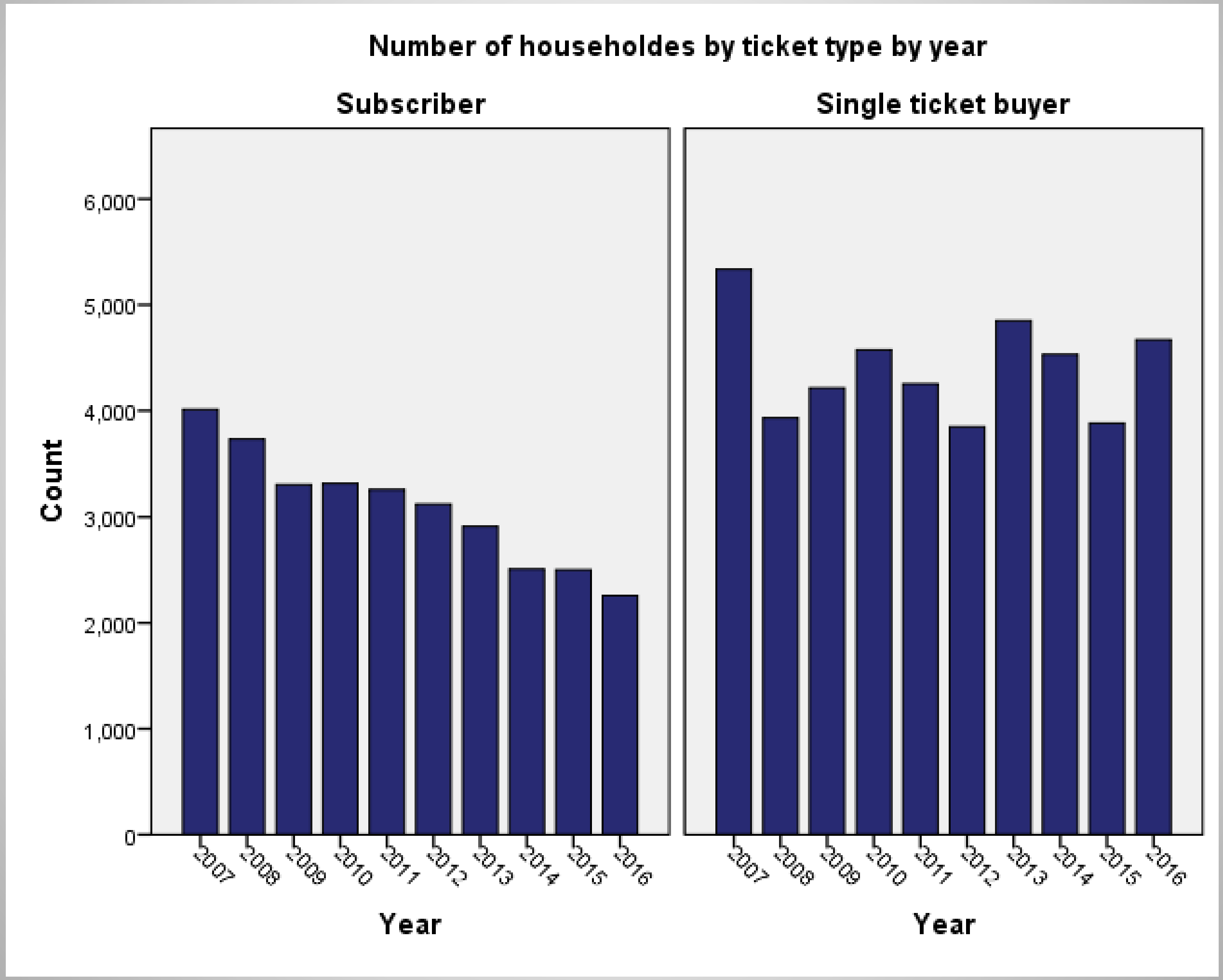
Uncovering the problem

- The revenue challenges – particularly those related to patron behavior – were most opaque to the company.
- Therefore, we focused on trying to uncover what was happening underneath the topline metrics they were using.
- And we asked for ten years of data to fully understand the storyline of the company.

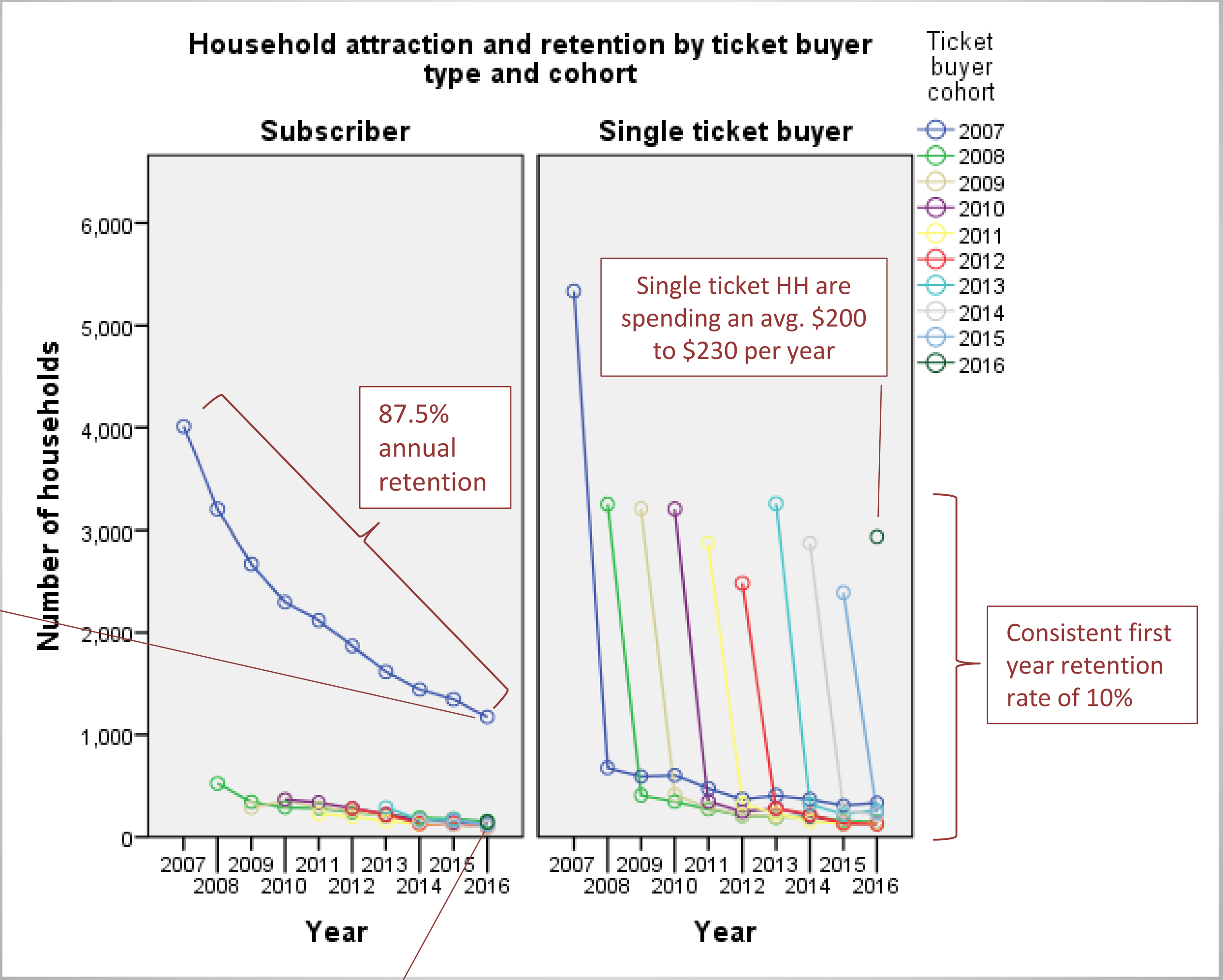
Another approach to patron analysis and modeling

- We deconstruct behavior into component pieces, such as:
  - Number of households (versus number of tickets)
  - Cohorts by first year of ticket purchase (versus new and return)
  - Buyer type (subscriber or single-ticket buyer)
  - Donor behavior, and its relationship to ticket-buying
- Then we look at trends within and among components over a ten year period.
- Which allows us to create a granular predictive model that projects based on past trends.

Top-line analysis trends



Looking underneath the trends



Each 2007 cohort sub HH spending an avg. $660 per year

Consistent first year retention rate of 10%

Each 2016 cohort sub HH spending an avg. $380 per year

What would this mean for households if trends persist?

Subscribers

	2016 actual	2017 model	2019 model	2021 model
2007	1,175	1,058	857	694
2008 – 2011	499	434	329	249
2012 – 2016	584	438	246	139
New		150	347	458
TOTAL	**2,258**	**2,080**	**1,779**	**1,540**

54%

45%

There are fewer 2007 cohort subscriber HHs, and they now make up a minority of the total pool.

Single ticket buyers

	2016 actual	2017 model	2019 model	2021 model
2007	335	285	206	149
2008 – 2011	551	468	338	244
2012 – 2016	3,785	1,014	732	529
New		3,000	3,555	3,956
TOTAL	**4,671**	**4,767**	**4,831**	**4,878**

Total number of single ticket households are growing, but it takes 5 years of 3,000 new households per year to net 200 sticky households.

What would this mean for revenue if trends persist?

Subscribers	2016 actual	2017 model	2019 model	2021 model
2007	$776,591	$697,950	$565,340	$457,925
2008 – 2011	$285,634	$247,454	$187,298	$141,766
2012 – 2016	$274,950	$219,000	$123,188	$69,293
New		$55,500	$144,094	$193,928
TOTAL	**$1,337,175**	**$1,219,904**	**$1,019,920**	**$862,912**

Single ticket buyers	2016 actual	2017 model	2019 model	2021 model
2007	$94,044	$79,730	$57,605	$41,620
2008 – 2011	$120,961	$107,721	$77,828	$56,231
2012 – 2016	$802,378	$233,163	$168,460	$121,712
New		$600,000	$727,650	$819,877
TOTAL	**$1,017,383**	**$1,020,614**	**$1,031,543**	**$1,039,440**
TOTAL TICKET REV	**$2,354,558**	**$2,185,017**	**$1,907,368**	**$1,708,424**

Over five years, the 55%:45% distribution flips from sub:single to single:sub.

Revenue declines are driven by the loss in subscriber households, especially those with high spend rates.

What would this mean for their capitalization?

Operating model

- Revenue becomes reliant on bumpier sources: single ticket sales and donations (which often come during the end of the calendar and fiscal years).
- Less, if any, net income hits the bottom line every year as revenue *at least* stays flat and expenses increase.

Liquidity

- A bigger infusion is required to support bumpier revenue coming throughout the season.

Operating reserve

- More is necessary to protect against negatively fluctuating results.

Risk capital

- Size the risk to fund potential deficits from staying the course.

Testing new strategies

- After reviewing the implications of current trends, the company’s leadership asked to test the impact of strategies that could improve the model.
- Based on the findings, they defined two potential strategic pushes:
  1. Can we lift average new subscriber household spend and do a better job retaining them?
  2. If we assume that 10% retention for first-time single ticket buyer households is unchangeable, can we find more of them and get them to spend more when they’re with us?

Defining strategy assumptions

- This approach allows us to measure the net impact of each strategy on the organization's bottom line.
  - Focusing only on gross revenue loses sight of the expense needed to move the dial, which could result in a bottom line that's more negative.

Strategy	Tactics and expenses	Behavior assumptions (by year 5)
Subscriber focus	• Series of post-performance, intimate subscriber events: $25K • Renewal time phone drive focused on new subscribers: $15K (marginal expense over planned drive) • Drive-time radio campaign: $60K	• New subscriber households goes from 150 per year to 200 per year. • First year subscriber retention will lift from 75% to 85% • Average spend for subscribers attracted after 2016 will lift from $400 to $550
Single ticket buyer focus	• Production-focused sales campaign across the season: $100K (marginal expense over planned campaign.) • Pre-performance happy hours and post-performance parties: $125K	• New first time single ticket households increases from 3,000 to 3,500 per year. • Average spend for first time single ticket households increases from $200 to $250.

Results of strategy modeling

Subscriber scenario					
	2017 model	**2018 model**	**2019 model**	**2020 model**	**2021 model**
Marginal revenue due to strategy	$6,801	$24,890	$54,838	$97,347	$153,496
Strategy expense	$100,000	$100,000	$100,000	$100,000	$100,000
Strategy net	$(93,199)	$(75,110)	$(45,162)	$(2,653)	$53,496
Single ticket scenario					
	2017 model	**2018 model**	**2019 model**	**2020 model**	**2021 model**
Marginal revenue due to strategy	$46,688	$99,175	$157,488	$221,714	$292,001
Strategy expense	$225,000	$225,000	$225,000	$225,000	$225,000
Strategy net	$ (178,312)	$(125,825)	$(67,512)	$(3,286)	$67,001

- Both strategies results in small net gains over the baseline projections by year five.
- Risk capital would be required to support the strategy's net loss as revenue matures.
  - Subscriber scenario: $216K
  - Single ticket scenario: $375K

What would this mean for their capitalization?

Operating model	• Revenue still becomes reliant on bumpier sources: single ticket sales and donations. • Net income could improve as long as strategic expenses are controlled. • The scale of the gain ($50K to $60K) does little to support the $1M needed in new annual funding.
Liquidity	• A bigger infusion is still required.
Operating reserve	• A bigger reserve is required since risk is added to the model.
Risk capital	• Funding strategies' negative net impact takes pressure off the operating budget and allows time to test and evaluate results.

What about a more disruptive shift in your model?

- How might you re-think your relational strategy to encourage stickiness and support donor cultivation amidst changing consumer expectations?
- What are the capitalization implications?

A case study

- A small, affordable, urban chamber presenter received funding (risk capital) to develop a response to broad consumer behavior trends that favor relational strategies.
- The backstory:
  - Topline financial trends were strong – no sharp subscription sales declines and overall growth coming from increased single tickets.
  - However, organization believed its relational platform was weakening based on trends toward single tickets and anecdotal observations that patrons were increasingly choosing multiple single tickets to have flexibility in scheduling and choice.
  - Experimentation with under age 35 membership programs offering a flat price for unlimited access appeared to show they have the seeds of an new relational model: increased revenue, more experimentation, lowered transaction costs, and stronger affinity.

The challenge

Transition to a general membership structure that integrates patron needs and organizational goals while managing risk.

Patron Goals

- Simple pricing
- Affordable pricing
- Satisfy desire for flexible concert choice
- Accommodate aversion to advance scheduling commitments
- Access to all concerts
- “All you can eat”

Business Goals

- Maintain or increase earned revenue
- Maintain or increase contributed revenue
- Increase attendance
- Lower transactional and marketing costs compared to single ticket sales
- Up-front cash and/or predictable cash flow

Mission Goals

- **Engagement:** free staff time to focus on audience education and engagement
- **Experimentation:** build audience interest in unconventional programs and younger, less well-known artists

Updated relational strategy
that encourages stickiness and supports donor cultivation

The approach

We worked through a process to understand the current trajectory, clarify lessons from the membership pilot, unpack the business logic of membership, and develop an implementation approach.

1 Research & Analyze

- **Observed patron behavior trends** through analysis of internal data.
- **Connected the dots to financial implications** – earned revenue, contributed revenue, cash flow, time, and scale.
- **Identified changing patron needs** drawing on internal customer observation and external field research.

2 Hypothesize & Refine

- **Developed membership scenarios** to address patron and organizational needs.
- **Identified unfamiliar business dynamics, cash flow implications, and other key risks** of membership.
- **Refined research** through benchmarking, focus groups, etc. to further detail approach.

3 Test & Iterate

- **Considered piloting** in a bounded fashion to limit risk and gain experience with unfamiliar dynamics.
- **Modeled and conducted sensitivity analysis** on pilot test concept and pricing.
- **Sized risk capital needs** based on potential financial downside.
- **Will consider expanding pilot** once proof of concept and understanding of new dynamics is established.

The findings: current trajectory

- **Analysis confirmed the shift to singles and also highlighted a long lead time on donor cultivation and a slow leak on subscription households.**
  - Households that bought only single tickets were trending steady to upward, and were buying more tickets on average.
  - At the same time, an increasing number of patrons were opting to buy multiple single tickets, apparently forgoing subscriber benefits to meet other needs.
  - Board members accounted for more than half of annual fund donations, and donations from non-board members were made by subscribing households that have very long-term relationships with the organization.
  - Subscription households declined over time, but spent and attended more – keeping revenue on track.
- **Projections showed that the current relational model remains strong.**
  - On its current track, the organization could experience a 4% loss in revenue in 5 years, and a 7% loss in ten years, without factoring in any price increases.

The findings: membership pilot

- **Analysis of the membership pilot cast doubt on the apparent evidence of improved revenue and overall applicability of the pilot to a general membership program.**
  - Members participated with unexpected frequency – attending 11 concerts on average.
  - Low price coupled with frequent participation meant that realized value per ticket was low ($5 compared to $19 for subscribers) – a clear risk factor and challenge for pricing a more widely available membership offering.
  - Member turnover was high, but “aging out” is a factor.
  - Members also generally did not donate, which is expected behavior in those who are new to the organization and/or young.
- **Benchmarking underscored the shifting logic of a membership approach compared to subscriptions and single tickets.**
  - Participation was unexpectedly high in several places – creating inventory management concerns.
  - Cash flow was a major consideration and others used both up-front and monthly strategies.
  - Cannibalization of high-value subscribers is a risk if membership is offered alongside traditional subscriptions.
  - Initiatives are new and little is known about the long-term payoff of membership in terms of donations.

The plan

- **Despite the apparent long shelf life of its current model, the organization remained convinced that rapidly changing consumer expectations called for experimenting with an updated relational approach.**
- **Rather than fully transition to a membership model, it decided to take advantage of its long runway to pilot a general membership.**
  - Unlimited, flat-price memberships will be offered alongside traditional subscriptions.
  - Exclusive subscriber benefits will limit cannibalization.
  - Focus groups will help to align membership features with patron needs.
- **This approach limits risk to current operations while allowing the organization to gather real-world data on the impact of membership on patron behavior and revenue.**
  - Key risk: unlimited access creates a revenue risk if participation is very high and tickets would otherwise sell at a higher price.
  - Key risk: unless the total number of memberships is limited during the pilot phase, membership could pose a large revenue and inventory risk.
  - Key risk: high-value subscribers could opt for a lower-priced membership.
  - The organization will seek risk capital to cover the downside risk of cannibalization and high average participation levels.

What does this mean for their capitalization?

Operating model	• With risk capital in place, the operating model should hold steady during the pilot phase – especially with small adjustments to pricing.
Liquidity	• As the single ticket shift continues, a capital infusion for liquidity purposes could be necessary.
Operating reserve	• As the single ticket shift continues, financial results are less predictable and a larger reserve could be necessary.
Risk capital	• Covering the revenue risk of the pilot with consumable capital allows time to test and evaluate results without de-stabilizing the overall financial picture.

QUESTIONS?