A Quick guide to Revenue model types

A revenue model describes how a business generates revenue streams from its products and services. It is one of the key components of the business model. Existing businesses interested in expanding to new areas or adjusting to a new generation of competitors should carefully consider their revenue models. A strong revenue model is also most important for early stage startups; their investors are usually very conscious of monetization.

There are many models for revenue generation, and the accelerated development of the Internet, social networks and smartphones is expanding the possibilities.

Listed below are 26 common revenue model types and examples of their effective use. Our list does not contain all possible revenue model templates and there may be some overlaps, derivatives, and combinations; however, it’s a good place to start.

Finally, we must distinguish between decisions about types of revenue models (e.g., monthly subscription vs. pay per transaction) and pricing decisions (price of $10 vs. $50). Pricing is important; many methodologies have been developed and pricing books were written (e.g. The Strategy and Tactics of Pricing by Nagle and Pricing with Confidence by Holden). However, pricing is not the topic of this post.

I divided the revenue models to nine major categories:

A. Commerce and retail
B. Subscriptions and usage fees
C. Licensing
D. Auctions and bids
E. Advertising
F. Data
G. Transactions/Intermediation
H. Freemium
I. Revenue model types common in financial services industry

A. Commerce and retail

Physical goods have been sold as long as markets have existed; later, services were offered, too. In recent decades, digital products have also been developed.

The basics of selling to private clients (B2C) and business clients (B2B) are similar. Usually, major challenges may include:

- Turning a one-time sale into a repeat sale or into a pre-sale of future products (e.g. adding the customer to the firm's loyalty club)
- Adding extra components to a basic product (e.g. insurance, financing, extended warranty, and premium accessories offered to car buyers)
- Selling a product that bonds the customers (classic examples: razors and blades; printers and ink cartridges)
- Finding a way to price with premium to market segments that are willing to pay for the additional value (e.g. first class on airlines)

1) Selling physical goods

The traditional retail world (high-street stores and malls) changed in the 90's when companies like Amazon emerged and, due to savings on expensive real estate costs, offered through e-commerce lower prices than stores did.

2) Selling digital products

Digital goods can be downloaded and consumed instantly and usually have neither additional production, shipping or inventory costs nor major quantity limitations. Digital products include, for example, songs, eBooks, games and apps for smartphones and tablets.

3) A service sold per unit

The work-hour is common among lawyers, accountants, consultants, IT integrators, etc. This model also exists on platforms such as Get A Freelancer and Elance.

Other widespread units include distance (taxi rides), weight (parcel shipment), and bandwidth (internet service providers).

4) A service with fixed price

Movie tickets cost the same amount regardless of the movie's length and quality or the seat's location. Women's hair salons sell different services for set prices: styling, coloring etc.

A current example: Fiverr, a marketplace where a wide range of small services (called 'gigs') – from translations and editing to graphic design and marketing – are offered for $5 each.

5) Sale of services for future use

These include pre-paid phone cards or credits for usage of photos from royalty-free sites like iStockphoto, where price per unit decreases as the quantity purchased grows (the seller enjoys receiving the deal's proceeds before usage).

6) Daily deals / flash sales

Daily deals (with players like *Groupon*) were trendy not long ago. Consumers gain an opportunity to purchase items at a steep discount; suppliers sell large quantities via the coupon company, allowing them to reduce marketing, sales and inventory costs.

B. Subscriptions and usage fees

7) Subscriptions

This model has existed for long time (e.g. newspapers, magazines, gym). It gained popularity in other domains, too: software (once dominated by the licensing model), such as LivePlan (for business plan preparation); movies (offered by Netflix), mobile carriers, and others.

Some subscription schemes offer unlimited usage; others have a specified cap above which they charge a higher rate.

8) Usage fees

In this model, the greater the usage, the higher the payment. Electricity, water, and gas bills fall into this category. Until recently, mobile phone carriers often used this model to charge for minutes of outbound calls and quantities of SMS text messages.

9) Rental

Rental enables multiple customers to enjoy the same asset at various times. Usually, rent is priced per unit of time (e.g., the traditional *Avis* and *Hertz* model of daily and weekly rentals). New-generation players like *Zipcar* rent by the hour.

C. Licensing

This used to be a common revenue model for software players. However, with the emerging trend of SAAS, licensing became less attractive (compared with the subscriptions model).

10) License of usage

This is a common model in Intellectual Property (patents, copyrights, trademarks). The license is usually limited by time, territory, types of products, volume, etc.

11) Certifications

A slightly different variation is the usage of certificates. For example, the McAfee SECURE trustmark for Internet websites.

D. Auctions and bids

12) Auctions

The traditional auction industry, led by brands such as *Sotheby's* and *Christie's*, changed in the '90s with the launch of eBay. It offered an online platform to connect buyers and sellers. Price is determined in a public auction, and eBay generates revenue streams from a variety of fees.

Lately, there is a trend of immediate fixed-price sales (compared to auctions) on eBay, implying possible change in users' preferences.

13) Dynamic pricing

Sponsored search results on Google's search engine, based on search keywords, are purchased through the *Adwords* system, which is based on dynamic pricing. The larger the demand for keywords, the higher the cost per click.

E. Advertising

The advertising revenue model is not new. However, the once-straightforward advertisments have become more complex and creative, and the industry evolves constantly.

Additionally, due to constant growth in information and its availability, large-scale revenue stream generation requires either great traffic or niche domination.

The Internet world has many advertising models: pay-per-views (CPM) as well as pay for behavior (clicks) like CPC and CPA. We will not dwell on them in this post.

14) Advertisements (e.g., text, banners, video)

In the past, advertisements appeared only in traditional media such as newspapers, magazines, billboards, television and radio. Today, by definition, advertising also includes the Internet and expands onto apps and mobile platforms.

15) Promoted content

Unlike ads, promoted content (also known as 'sponsored' or 'suggested' content) looks similar to regular user content. Users may give it more attention or perceive it as more credible than other advertisements; some users may even be oblivious to the fact that someone paid to promote the content.

This model is common on social networks such as *Facebook* and *Twitter* as well as websites like *Yelp*.

16) Sponsorships

Companies may sponsor, for example, sports events, conventions, websites, and TED talks.

F. Data

17) Databases

High-quality data (e.g. an index of qualified service providers in a specific domain) is valuable.

- The more exclusive the information, the greater the value.
- The usage will be more valuable (and expensive) when the data is enriched with profound analysis.
- Some entities specialize in lead generation: creating and maintaining names and contact information of potential customers and selling them to 3rd parties.

It should be mentioned that for ventures such as Google, Twitter and Facebook, which aggregate high quantities of data about users, the revenue engine is not sales of databases to 3rd parties. Rather, these sites focus on advertisements based on customer data. The idea of aggregating and using data about users who do not pay for the services is the origin of the phrase, 'If you are not paying for the product, you are not the customer, you are the product being sold.'

G. Transactions / Intermediation

18) Brokerage

The Internet and other technological and social developments hurt many intermediaries, and the future of middlemen is questionable. However, middlemen still have some important roles in connecting parties (fees are usually calculated by percentage of the transaction, but there is sometimes also a minimum payment.). Real estate brokers and M&A investment bankers fall into this category of intermediaries.

Many service providers to companies and startups are compensated by stock options that represent specific percents of the company's overall equity. Often members of the board of directors and of advisory boards are compensated in a similar manner.

19) Transaction enablers

Some entities enable transactions between other parties. Here, too, the fee is usually a specific percent of the deal. For example, *PayPal* enables payments that minimize credit risk (for sellers) and increase information and purchase security (for buyers).

20) Affiliate Programs

Typical affiliate programs, common in internet marketing (from huge players like Amazon to small-scale blogs), include sellers of products/services and parties that drive traffic to the sellers. Some affiliates explicitly state that links to 3rd parties may entitle them to compensation.

Affiliate programs often use revenue-sharing mechanisms (50/50, or another agreed upon revenue allocation). Others may use different compensation mechanisms such as CPM, CPC and CPA (mentioned earlier).

21) Creating a platform / marketplace

The Internet creates a unique and excellent opportunity to easily connect sellers with consumers:

- *Airbnb* enables homeowners to offer accommodation to tourists who are not interested in hotels
- *Etsy* links artists and art seekers
- *CDbaby* does the same with music

The platform manager usually maintains and upgrades the platform and takes care of customer service, payment collection, mediation, etc. Airbnb also offers insurance. Platform managers usually are not involved in creating the product shipment and do not hold inventories.

The revenue model is usually a specific percent of the deal (Apple's iTunes and App store take a 30% cut of each sale).

- Some marketplace coordinators collect from both parties to the transaction; others collect from only one party (which subsidizes the other party).
- Some platform managers (like *Kickstarter*) are entitled to revenues only if the desired deal is fulfilled.

H. Freemium

The Freemium model has enjoyed much success in the last decade, although recently there is a debate whether the Freemium days are over.

The Freemium idea is based on providing a basic version of the product for free and charging a premium for the full version. Usually, few customers buy the premium version.

Business models involving Freemium are very common, especially for providers of mobile applications, which generate huge revenues through in-app purchases and upgrades.

There are several variations on the Freemium theme (to be detailed below), and there are some mixtures and derivatives of these archetypes.

22) Paid version without advertisements

Many games and applications' free versions include (often annoying) advertisements. The paid version enables usage without ads, thus improving the user experience. Usually, the revenues from upgrades exceed those generated by the ads.

23) Paid version without restrictions

Often the free version has usage limitations: levels in a game, storage volume, number of users, and more. Paying for the premium version enables unrestricted use. It is convenient, for example, for wireframe applications in which mock-ups should be shared between various members of a design team.

24) Paid version with additional features

One of the most effective ways to generate revenue is to sell specific features and functions that are not included in the basic free version, such as additional "lives" or exclusive weapons in games.

This model often maximizes revenues per customer, as loyal customers may spend a lot for additional features.

I. Revenue model types common in the financial services industry

The financial world, offering a unique product (i.e., money), has special types of revenues.

25. Interest revenues

Banks charge higher interest for loans than they give for deposits. The gap between these figures, also known as the 'interest spread', should compensate for credit risks and operational risks, and has traditionally been banks' main source of revenues.

Today, a new wave of online ventures, such as Zopa and Funding Circle in the UK, presents a small-scale alternative to banks. Since they have a smaller workforce and no physical and costly branches, these enterprises may offer borrowers and depositors better interest rates than full fledge banks do.

26. Asset management fees

Asset managers, institutional investors and similar entities that manage investments for their clients make their living from fees. For example:

- Percentage of the overall customer's assets being managed
- Percentage of new money transfers by the customer to the money manager
- Percentage of the returns (also known as carried interest) that some investment professional generate in excess of an agreed upon hurdle rate.

Recently we witness also new players (for example, Nutmeg) offering online investment services in return for a specific percent of the managed assets.