MONETIZING **RECURRING REVENUE** MODELS

What CFOs Need to Know About Flexible Pricing Strategies

INTRODUCTION

Recurring revenue business models, often deployed through subscription or usage-based revenue streams, have become popular among software and technology vendors in recent years. But this emerging revenue stream is also creating new opportunities across most industrial sectors, including manufacturing, financial services, healthcare, media, business services, transportation and logistics, and leasing. In fact, according to a recent CFO Research study, more than half of surveyed senior finance executives report that at least 40% of their current revenues are recurring, and even more finance chiefs expect to reach the 40% level in five years.

Organizations are drawn to this new recurring revenue business model because they offer steady and

predictable revenue streams with reduced risk and a high potential for growth. For some organizations, transitioning to a recurring revenue model provides a path to new markets and geographical regions. For others, the competitive landscape is driving the need to adopt this business model. Whatever the business reason for the shift, recurring revenue models are the future, and CFOs are positioned well to guide their organizations through this transformation.

To be successful, CFOs need to adapt and learn how to monetize recurring revenue models to drive business strategy and profitability.

As companies adopt or expand their reliance on recurring revenue, they need a modern monetization platform that supports the entire order to cash process. When finance deploys a flexible monetization platform, they can help to promote experimentation with business models and pricing and allow the organization to operationalize successful practices and change their approach as they learn what works. This white paper will explore:

- The challenges of moving to a recurring revenue model, including the limitations of traditional spreadsheets and custom systems to handle multi-attribute pricing models.
- Best practices for transitioning to a recurring revenue model, including changes to how the business is analyzed and how the CFO can lead the shift in mindset.
- The benefits of a recurring revenue business model, including deeper customer relationships and a more predictable cash flow.

OPERATIONAL AND CULTURAL CHALLENGES OF TRANSITIONING TO A RECURRING REVENUE STREAM

Shifting to a recurring revenue business model requires most organizations to change their mindset about pricing. For most companies the adjustment entails thinking about pricing as an evolving process and a range intended to spark customer activity, rather than a fixed point. This requires time, data, research, and a willingness to understand what is profitable and adjust when the data proves a strategy isn't working.

For example, some companies may choose to test recurring revenue with the launch of a new product or service. Before going to market, the CFO can help the organization to choose not only a price point but also a pricing model. As sales people try the pricing model and contracts are signed, the company will gain deeper insight into what works based on adoption rates, relative popularity, usage volumes, and other key metrics. Periodically, the pricing can be adjusted to optimize business outcomes.

With the right financial technology, companies also gain the ability to leverage multi-attribute pricing which enables many more options for pricing their offerings. Multi-attribute pricing gives companies the freedom to assign different prices to different elements of their offerings and automatically derive the correct price

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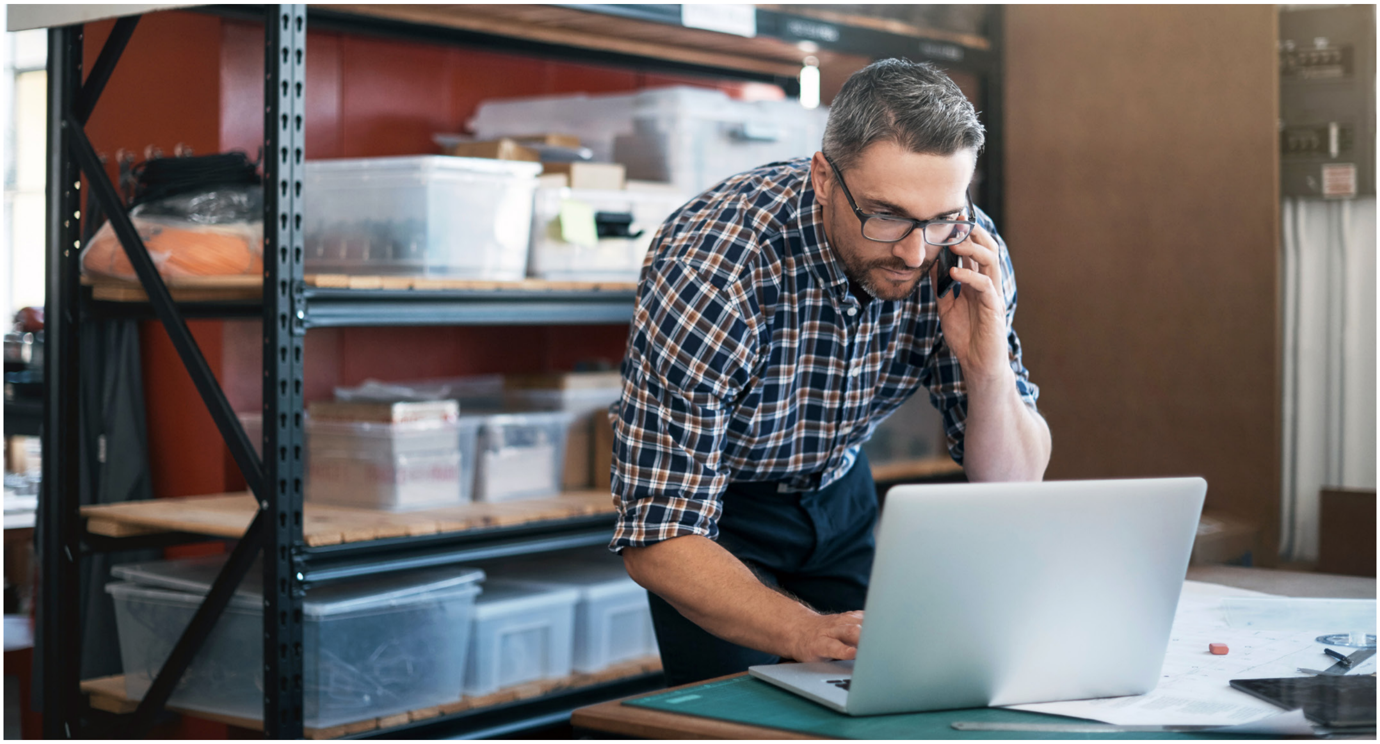
> **— Jeff Wissink, Managing Director, Navint Partners**



using a rules-based engine that can consider various conditions, such as type of service, usage volumes, time of day, and location that the product or service was used by the customer. These companies can be more flexible in their pricing options, such as allowing customers to pay only for what they use, offering volume discounts, delivering one-time add-ons, accounting for seasonal variations, and so on. The companies that take advantage of multi-attribute pricing gain a competitive edge and have more paths to profitability because they can tailor pricing to the specific requirements of a customer while also considering the variance in costs incurred while delivering services.

"It is a huge change in how to think about the business from a profitability, organizational, and technology perspective," according to Jeff Wissink, Managing Director, Navint Partners, a management consulting firm. "They have to move from a transactional relationship — making that one-time sale — to pricing and business models that change and evolve as relationships change and customer needs change."

However, there are challenges for the CFO in this effort: current legacy and custom systems and spreadsheets are not built to process, track, and manage recurring revenue and more flexible pricing models.

Older systems were developed to support relatively fixed pricing and a one-time sales model rather than multiple transactions over the year as the customer uses the product or service. These systems often were developed by the IT department over a period of several years and usually require IT intervention to make changes; a process that takes too long, slows pricing and business model experimentation, and prevents the fast and frequent adjustments often needed to respond to the market.

Instead, CFOs need monetization systems that allow them to be flexible in their pricing models and that enable experimentation. Savvy CFOs know that the flexibility in the order to cash process is critical to the success of new business initiatives based on recurring revenue. A recent CFO Research study found that 65% of senior finance executives are exploring new systems and processes to better support recurring revenue business models.

BEST PRACTICES FOR IMPLEMENTING FLEXIBLE PRICING MODELS

The future points to a recurring revenue model as the rule rather than the exception, and CFOs need to determine the best ways to leverage this new strategy to maximize value to the organization.

CFOs of companies where at least a portion of the business comes from recurring revenue should use new metrics to analyze the profitability of customer transactions to identify the most effective models for contracts and pricing. Metrics that companies can use to track and evaluate which bundles, contracts and pricing models are working include:

- **Customer Lifetime Value (CLV).** This examines the ability to build and maintain profitable customer relationships over time.
- **Cost to Acquire a Typical Customer (CAC).** The best SaaS businesses are able to recover the cost of acquiring a new customer in five to seven months.
- **Net New Business Revenue.** This indicator is particularly important in situations where customer acquisition is a priority.
- **New Revenue from Existing Customers.** This metric tracks the new products and services purchased by current customers, a key indicator of customer satisfaction.
- **Customer Churn Rate.** Net Customer Retention is an associated metric, as it looks not just at the customers who left, but the ability to bring in new business to replace lost business.

CFOs SHOULD LEVERAGE **NEW METRICS** TO ANALYZE THE **PROFITABILITY OF CUSTOMER TRANSACTIONS** TO IDENTIFY THE MOST EFFECTIVE MODELS FOR CONTRACTS AND PRICING.

These key indicators uncover correlations between pricing and contracts and customer satisfaction, providing insight for product management, customer service, sales, and marketing – essentially, the entire organization.

The result: the ability to pinpoint opportunities to standardize on the most profitable models across the customer base, improve sales effectiveness, and promote predictable revenue streams.

CFOs ARE ATTRACTED TO THE **MORE RELIABLE AND PREDICTABLE** REVENUE STREAM OFFERED BY RECURRING REVENUE MODELS.

BENEFITS: A MORE PREDICTABLE REVENUE STREAM AND DEEPER CUSTOMER RELATIONSHIPS

Most companies don't completely abandon their traditional pricing models for a recurring- revenue strategy; the percentage of revenue they receive from recurring business increases over time. Along the way, the company can analyze the data to adjust their pricing structures incrementally to improve profitability.

For the CFO, a main attraction of a recurring revenue model is a more reliable and predictable revenue stream. The CEO and finance leadership both need an accurate view of cash flow to make more reliable decisions about funding innovation and expansion.

Predictable revenues are also attractive to Wall Street, potential acquiring companies, and investors, who value companies with recurring revenue models as much as eight times greater than comparable companies with transaction-based pricing models, Navint Partner's Wissink noted.

A subscription-based pricing model has the potential to lower operating costs, which improves profitability. Instead of throwing more resources at an inefficient process and chasing customers that aren't necessarily the most profitable, the flexible pricing model focuses efforts on the deals that will yield the best long-term results. The data also points to identifiable upsell and cross-sell opportunities that are limited when customers make one-off purchases.

The recurring revenue model also means interacting with customers much more frequently than before. "Ultimately every function — sales, billing, invoicing, collections — is a customer-facing function in a recurring revenue pricing model," Wissink noted. With the right monetization technology, more frequent interactions delivers enhanced data and visibility surrounding customer sentiment and enables more nimble decision-making. Knowing more about customers also provides opportunities to reduce friction, which is critical to building loyalty.

CONCLUSION

Transitioning to a multi-attribute pricing model will help stabilize revenue streams and provide valuable insights to help attract and retain new customers.

This pricing approach requires organizations to rethink not only their approach to pricing and sales, but technology. Many ERP, CRM, and financial reporting systems are geared toward traditional pricing models.

There are a number of reasons that CFOs should familiarize themselves with a multi-attribute pricing model, not the least of which is a steady stream of revenue to smooth out cash flow. More agile and nimble pricing structures will pave the road to profitability as more customers buy products and services that are competitively priced, which encourages long-term relationships.

Key takeaways:

- Recurring revenue business models have captured the attention of CFOs because it offers significant benefits for the organization.
- Current technology doesn't seamlessly support multi-attribute pricing that customers have come to expect.
- Systems and strategies should position the company to monetize recurring revenue and track metrics, including churn rate and customer lifetime value, that are not typically the focus of traditional pricing models.
- In the end, more reliable revenue streams and deeper customer relationship make the recurring revenue business model more attractive to customers and potential investors.

About the Sponsor

RecVue delivers the only monetization platform built on big data and designed specifically to address the unique challenges of managing recurring revenue for B2B enterprises. These enterprises need an industrial-grade monetization solution to manage millions of transactions and a very high degree of complexity. RecVue's solution includes data mediation tuned to support high volumes of transactions, a 360 view into the entire contract lifecycle, attribute-based pricing, complete billing-to-invoice capabilities, partner management, and robust analytics and reporting.

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