

The CFO Series: Challenges in Adapting to Recurring-Revenue Business Models

INSIDE! ↘



Recurring-revenue business models, also known as subscription or usage-based models, are creating new opportunities across all industries—even in sectors where they haven't traditionally appeared before. Advances in social media, mobile devices, cloud computing, artificial intelligence, robotics, and the Internet of Things (IoT) are now enabling businesses to leverage these new models to generate entirely new revenue streams.



Companies are adopting recurring-revenue business models, also known as subscription or usage-based models, across all industries. Chief financial officers are leading this change and enjoying the benefits, but also face significant challenges, from collaborating with sales and service to adhering to new accounting and reporting requirements. Companies must deal with many operational challenges as they adapt



Recurring-revenue business models are spreading to companies across all industries and are augmenting, or in some cases replacing, existing transaction-based models. As companies transition to recurring-revenue, also known as subscription or usage-based models, they are benefiting from the increased revenue opportunities and smoother revenue streams. CFOs and their financial teams can benefit from the data produced under the new models with



The Growth of Recurring Revenue Business Models



Recurring-revenue business models, also known as subscription or usage-based models, are creating new opportunities across all industries—even in sectors where they haven't traditionally appeared before. Advances in social media, mobile devices, cloud computing, artificial intelligence, robotics, and the Internet of Things (IoT) are now enabling businesses to leverage these new models to generate entirely new revenue streams.



A recent online survey of senior finance executives by CFO Research and Salesforce shows that recurring-revenue models are well-established and growing. And the business case for the recurring-revenue model is strong: It focuses on the customer relationship, aligning the success of the customer with that of the business, which opens new growth opportunities. Additionally, companies gain smoother and more predictable revenues and higher valuations from investors. Key findings from the study include:

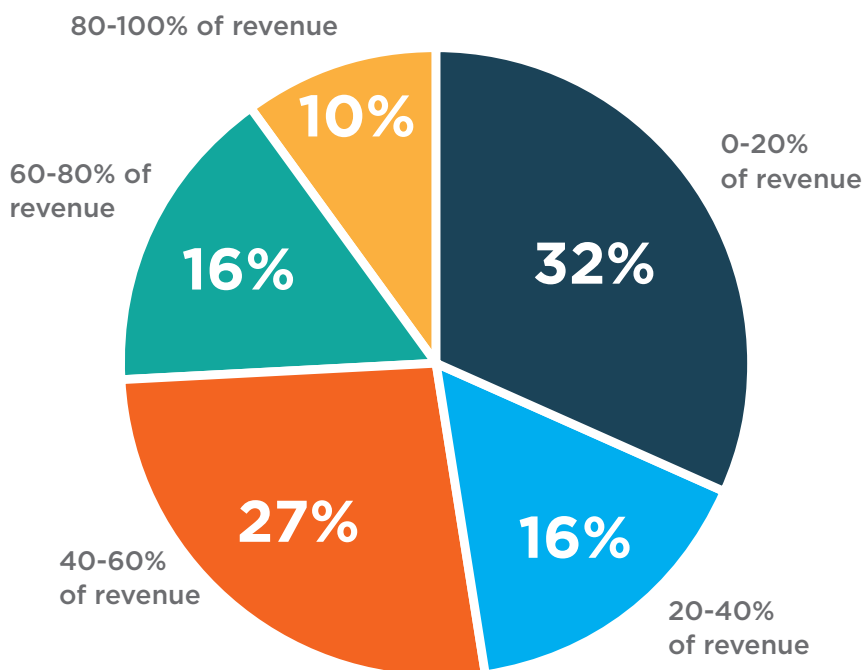
➤ **More than half** of surveyed finance executives report that at least 40% of their current revenues are recurring, and even more of them expect to reach the 40% level in five years. Trends were remarkably consistent for respondents from companies in a wide variety of industries—the growth of IoT and cloud-delivered services is clearly enabling adoption in non-traditional industries such as manufacturing.

➤ Recurring-revenue/subscription models improve customer relationships and generate more sales and marketing opportunities than traditional transaction-based business models. In turn, smoother revenue streams from recurring-revenue models enable CFOs and their companies to improve planning and forecasting. And lastly, investors value improvement in business results as well as the predictability of those results, both driven by recurring-revenue business models.

Established and Growing

More than half (52%) of the CFO Research/Salesforce survey respondents have companies where at least 40% of revenues are recurring, i.e., from subscription or usage-based business models. See Figure 1. This reflects the trend of companies in a broadening set of industries adopting the model. Software-as-a-service, health and nutritional supplements, media streaming, telecommunications and cable TV, utilities, digital publishing, and

FIGURE 1
The percentage of my company's revenue that is currently recurring (e.g., subscription or usage-based)



Percentages do not add to 100 due to rounding.

big-data companies have widely adopted recurring-revenue/subscription models. But the model has also taken root with companies in industrial sectors, like heavy equipment makers, and in sectors like medical devices. More companies will adopt recurring-revenue models as technologies like IoT devices are incorporated into business lines.

The survey of finance executives shows that trend toward future expansion, with **55% of respondents** estimating that in five years over 40% of their companies' revenue will be from recurring sources.

Other members of the C-suite, as well as company board members, are becoming increasingly aware of recurring-revenue business models and are committed to developing them, the CFO Research/Salesforce survey shows. According to the survey, **23% of C-suites and boards** at respondents' companies are incorporating

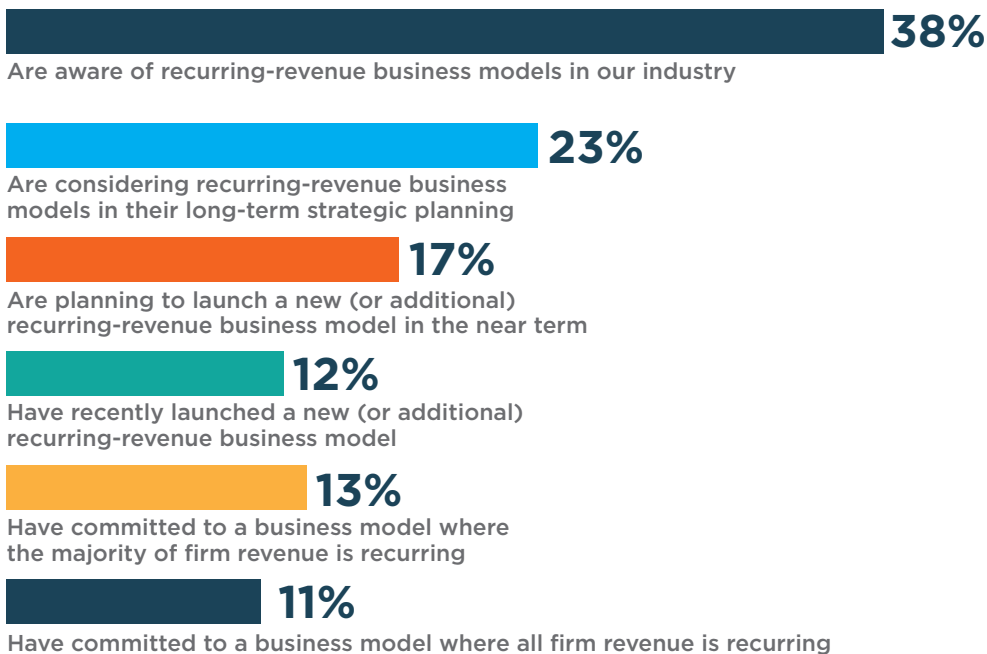
recurring-revenue business models in their strategic planning. Also, 17% of C-suites and boards at respondents' companies are planning to launch a new or additional recurring-revenue business model in the near term. See Figure 2.

Why Recurring Revenue

Companies are turning to recurring-revenue/subscription business models for several reasons. For some companies, transitioning to recurring revenue is a natural change as the economy shifts to a service economy, and these revenue streams present a path into new markets. For others, the competitive landscape is driving their business model change. IoT connectivity and cloud-delivered services are also setting up more companies for recurring-revenue/subscription models, along with business lines related to social media, mobile devices, and even market opportunities involving robotics and artificial intelligence concepts.

FIGURE 2

"My C-suite and Board ..."



Multiple responses allowed.

Companies may transition to recurring-revenue models because they seek the benefits of establishing long-term relationships with their customers, or to better meet the expectations of today's customer bases that prefer a relationship-based model. Most companies aren't transitioning from traditional transaction-based business models to recurring-revenue/subscription models all at once, or abandoning their current business models, but rather are leveraging these models to expand into new markets, making the change over time instead.

The Advantages

There are also several clear advantages to adopting a recurring-revenue model. The recurring-revenue/subscription model produces a more predictable revenue stream that is smoother and easier to model, so business forecasts are more accurate. Recurring-revenue/subscription models also lower the long-term costs of sales, because customer relationships are no longer one-time sales transactions. After the relationship is created, the model establishes a renewal event, which creates cross and upsell opportunities, further strengthening and developing the relationship. The ongoing relationship can also help the company penetrate new markets in other business lines.

In a recurring-revenue model, the first sale is seen as the starting point for growing revenue with each customer, which is a shift from the traditional transaction-based business model. Under a recurring-revenue/subscription model, sales and marketing can target at least five types of transactions: the initial sale, a subscription renewal or extension, an upgrade to a higher level of services, an add-on of more services, and the potential salvaging of service just prior to cancelation.

From a finance perspective, CFOs enjoy several benefits from recurring-revenue business models. Finance gains more financial controls, and better controls, and compliance is improved under recurring-revenue/subscription-based models. Also, the quality and speed of decision-making for the company improves because more real-time data is available, and the data is more frequent and more accurate. With smoother revenues—a series of payments over a product or service's lifetime instead of a single upfront payment—revenues are more predictable and less likely to drop off suddenly, which makes planning by finance easier. The predictability of revenues is also a boon for investors, who value companies with recurring-revenue models as much as **eight times greater** than comparable companies with transaction-based business models.¹

Conclusion

There's a lot for CFOs to like about recurring-revenue/subscription-based business models, i.e., benefitting both their companies and investors. Those benefits are key drivers for companies adopting recurring revenue, including smoother revenue streams, stronger customer relationships, and greater sales opportunities with those customers. CFOs also enjoy more accurate and quickly available financial data for improving their forecasting and decision-making capabilities. There is a clear growth opportunity in recurring-revenue businesses. Company Boards and C-suite executives across all industries² are taking note and taking steps to launch and grow their recurring businesses.

¹ Jeff Wissink, Managing Director of Navint Partners, *Gearing Up for New Revenue Models*, CFO Publishing, September 2018.

² The industries most frequently represented by survey respondents were: financial services/real estate; auto/industrial/manufacturing; education; insurance; business/professional services; health care; transportation/warehousing; wholesale/retail trade; construction; and energy/utilities.

The Challenges Finance Faces in Managing Recurring Revenue



Companies are adopting recurring-revenue business models, also known as subscription or usage-based models, across all industries. Chief financial officers are leading this change and enjoying the benefits, but also face significant challenges, from collaborating with sales and service to adhering to new accounting and reporting requirements. Companies must deal with many operational challenges as they adapt



to recurring-revenue models, accommodating a series of different types of transactions with the subscription customer and cultivating a new type of customer relationship.

The CFO Research and Salesforce survey confirmed that:

- Most companies launching recurring-revenue business face operational challenges, and many recurring-revenue business models cause accounting and reporting challenges for respondents.
- Customer contract renewals create operational challenges for most companies, often relying on manual processes and CRM/ERP systems that are designed for transactional businesses.
- There is an opportunity for sales, service, and finance groups to interact more effectively under a recurring-revenue business model, boosting collaboration based on the customer relationship.

Challenges Galore

Recurring-revenue business models, including both subscription and usage-based models, can create operational challenges. The CFO Research/Salesforce survey unveils some of the issues that can lead to those challenges.

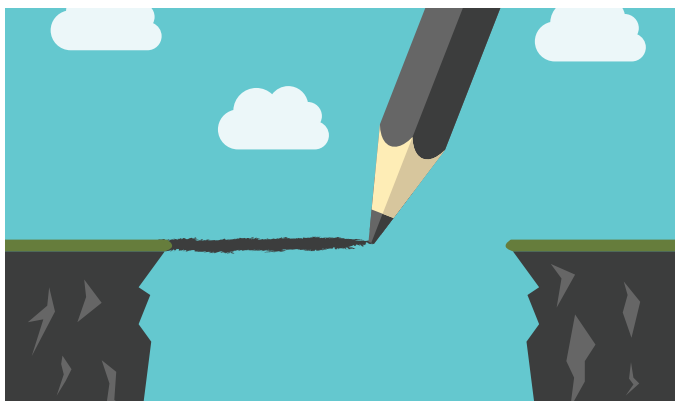
Nearly two-thirds (64%) of the senior finance executives surveyed by CFO Research and Salesforce say they face operational challenges with renewing customer contracts. This is clearly a significant problem for many businesses, and there are several contributing factors. When a company is transitioning to a recurring-revenue model, sales, service, and finance functions must all work together. Often these departments are housed in their own individual silos, both in their systems and their processes. See Figure 1.

Renewals can require the same level of attention as new sales—sometimes even more—and a company's sales efforts can be overly concentrated on landing new business. Importantly, many of these

FIGURE 1
The Scope of
the Challenge
for CFOs



*Multiple responses
allowed*



selling opportunities may be handled by people who aren't directly in sales, such as customer service. Process-driven delays can reduce opportunities for renewals, and the sales department can demand flexibility in product design and pricing, which can result in manual downstream processes.

Companies with one-time order-based business models may have not needed their sales, service, and finance functions to collaborate, because the sales transaction and the customer relationship are different than with recurring-revenue/subscription models. Companies with recurring-revenue models must accommodate many different types of transactions, including legacy products, as well as new business models.

The CFO Research/Salesforce survey also shows that, of the companies launching recurring-revenue businesses, **nearly two-thirds** (65%) face operational challenges in doing so. These companies may not be set up to process, track, and manage recurring revenue. They may not be set up to manage and leverage the data produced under a recurring-revenue/subscription model, and they may not be focused on the correct business metrics that the new business model demands. Calculating and managing pricing becomes much more challenging because prices can vary according to subscription levels, term lengths, and bundling with other products or services.

The CFO Research/Salesforce survey also shows that, of the companies launching recurring-revenue businesses, nearly two-thirds (65%) face operational challenges in doing so.

Changing the Culture About the Customer

Another operational challenge with recurring-revenue/subscription models is the culture shift required to build and grow a recurring customer relationship. Instead of relying only on sales, the entire business, from customer service to finance, needs to focus on how to drive customer success and grow the relationship over time.

Sales and marketing become more involved in the lifecycle of the customer and all of the potential transaction points after the initial sale, not just customer acquisition. Nearly all of the non-sales groups in the company become customer-facing. Interactions between finance and accounting, service, and sales and marketing occur daily, not quarterly, and the interactions are also more elaborate because the groups need to become more aligned in their customer focus.

Companies that launch recurring-revenue/subscription-based business models frequently have to rely initially on manual processes to link their existing CRM and ERP systems. Because most ERP systems are designed to handle transactional businesses, they don't work well when the element of time—or selling something across multiple periods—is introduced. The time element changes the way that a company must manage orders, invoices, and collections. Typical events in the subscription model, such as add-ons, upgrades, and

changes to the subscription, look like exception events to the back office, which leads to extensive manual data entry, rebills, credits, adjustments, and cancellations.

According to the surveyed financial executives, **nearly half** (48%) of companies with a recurring-revenue business model struggle to meet accounting and reporting challenges created by the dynamic relationship. More specifically, revenue has to be recognized according to ASC 606/IFRS 15 standards, which requires finance teams to report revenue based on commitments made in the contract. The only way to automate this process is to ensure sales is following a standard quoting process that delivers structured contract data. Additionally, this process must be carefully designed and maintained; otherwise, problems can arise such as mismatched proration calculations. If not properly managed, these problems can lead to audit and compliance issues.

The CFO Research/Salesforce survey concludes that companies are already seeking solutions related to recurring-revenue challenges. **More than two-thirds** (68%) of the survey respondents say they are actively exploring implementation of new systems and processes across sales and finance to better support recurring-revenue business models.

Conclusion

Under recurring-revenue/subscription business models, smoother and more predictable revenue streams should make for easier forecasting and more accurate forecasts for finance, along with more and better financial controls, improved compliance, and more real-time data for better financial analytics and decision-making.

But the recurring-revenue/subscription models also bring specific challenges for the corporate

More than two-thirds (68%) of the survey respondents say they are actively exploring implementation of new systems and processes across sales and finance to better support recurring-revenue business models.

finance function, and CFOs need to plan accordingly. Renewing customer contracts is challenging for most companies, and revenue recognition is more complicated than with traditional transactional businesses. Many ERP systems aren't designed for recurring-revenue businesses, and finance has to collaborate more with sales, service, and other groups in a recurring-revenue company, as all turn to focus on the customer relationship.



CFO Coordination with Sales Is Essential to Delivering Improved Results



Recurring-revenue business models are spreading to companies across all industries and are augmenting, or in some cases replacing, existing transaction-based models. As companies transition to recurring-revenue, also known as subscription or usage-based models, they are benefiting from the increased revenue opportunities and smoother revenue streams. CFOs and their financial teams can benefit from the data produced under the new models with



improved planning and analytics, but in many cases need to change the way they operate by breaking down silos with other departments. More specifically, improved coordination between sales and finance teams can help solve many of the challenges that arise under recurring-revenue/subscription models.

The CFO Research and Salesforce survey confirmed that:

- The top “pain points” for CFOs are: renewals forecasting and management, inaccurate sales or financial forecasting, inaccurate reporting, manual processes to create or manage orders or invoicing, and collections difficulties due to invoice disputes. It is clear that better coordination between finance and sales leadership can help improve these all of these issues.
- Companies should consider adding recurring-revenue/subscription models, which may require adding new systems to handle the

quoting, billing, bundling, and revenue-tracking challenges. In addition, most companies would benefit from a dedicated pricing and quoting system supporting multi-channel commerce.

Pain Points

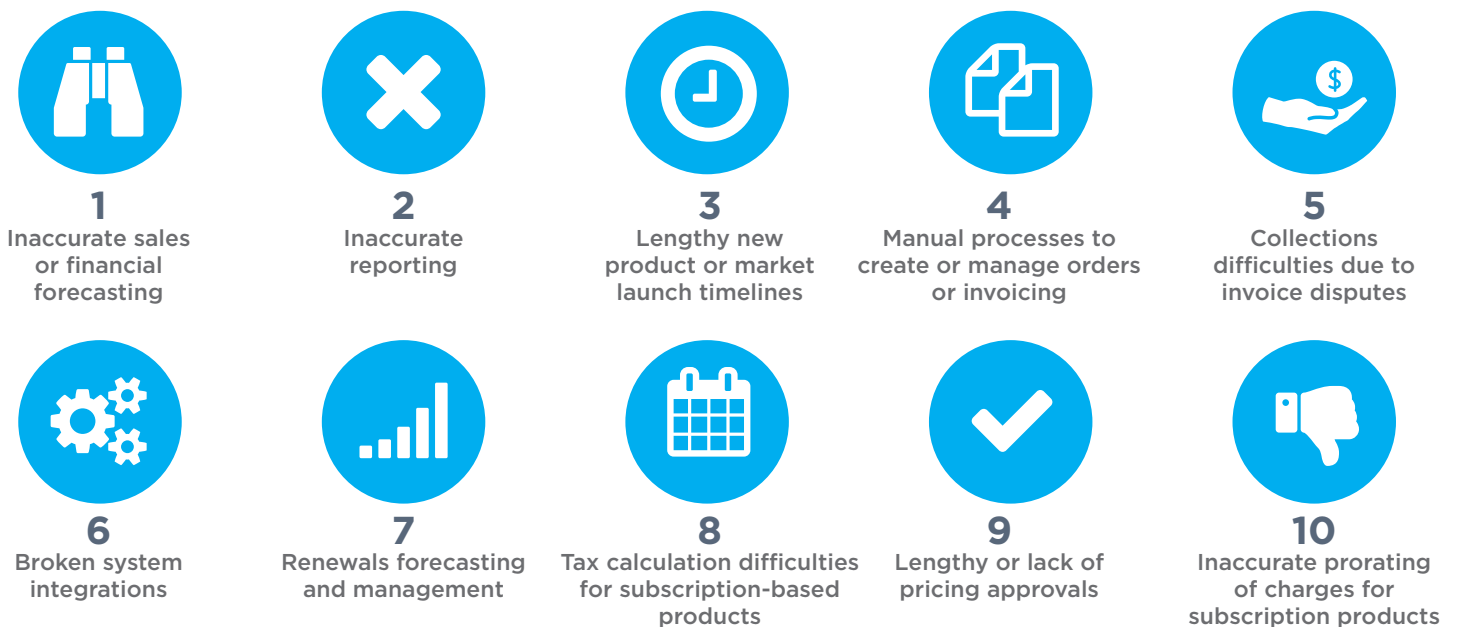
The CFO Research/Salesforce survey shows that recurring-revenue business models are increasing the pressure felt by CFOs and their finance groups. The survey asked the CFOs and other senior finance executives to **identify the pain points that are their highest priority to solve.**

This list was led by inaccurate sales or financial forecasting, inaccurate reporting, lengthy new product or market launch timelines, manual processes to create or manage orders or invoicing, and collections difficulties due to invoice disputes. See Figure 1.

Better coordination between sales and finance can address each of these pain points for the

FIGURE 1

The Top 10 “Pain Points” that Are a Priority for My Organization to Solve



CFO while also boosting corporate results. The surveyed executives agree with this assessment:

Two-thirds (67%) of respondents believe that finance leadership should better align itself with sales leadership to improve forecasting and maximize revenue growth. **More than eight in ten** (81%) say that sales and finance would benefit from improved collaboration and better communication about customers and contracts.

CFOs are typically responsible for leading business model transition and must properly plan for how it can affect other departments. The change of business models demands a culture shift, with nearly every group in the company effectively becoming “customer-facing” as every customer interaction contributes to the overall experience and success. In addition to understanding how to work together to drive growth, CFOs must set and leverage new key performance indicators, including building a framework to capture accurate performance data, for financial planning and analysis purposes.

With these transitions, collaboration with sales (and sales leadership) is crucial. Under a recurring-revenue/subscription model, sales becomes involved with the customer from the initial subscription through the lifetime of the customer relationship, with opportunities to sell through renewals, upgrades, and add-ons



More than eight in ten (81%) say that sales and finance would benefit from improved collaboration and better communication about customers and contracts.

Coordinating with Sales

Many substantial opportunities are created by better coordination between sales and finance. **Most** (57%) of the surveyed finance executives believe that solving their “quote-to-cash” pain points would decrease finance and sales costs by at least 5%. A similar majority (55%) also believe that it would increase enterprise revenue by at least 5%. And **nearly three-quarters** of respondents (73%) say that sales and finance would benefit from a solution that supports dynamic and recurring contracts.

More than seven in ten of the surveyed finance executives (71%) think that a more efficient pricing and approval process would substantially improve their organizations’ profitability. And **nearly two-thirds** (66%) say that their organizations would benefit from a dedicated pricing and quoting system that supports multi-channel commerce.

Unfortunately, many sales and finance teams live in separate CRM and ERP systems are designed for transactional businesses. Recurring-revenue business models introduce the element of selling over time, which changes how sales and finance leverage their systems and information.

Typically, companies that transition to a recurring-revenue model try to make do with their existing systems as they grow. But when they reach \$75 million to \$100 million of annual recurring revenue,

the problems with the old systems start becoming insurmountable. **Nearly two-thirds** (67%) of respondents are actively exploring new processes or systems to support recurring-revenue business models.

Bundles of Joy

One example of a problem that arises when traditional systems try to handle a recurring-revenue model is with bundling. When a subscription product or service is bundled with upgrades or add-ons, a traditional system can create a new SKU with every change to the bundle, over a dizzying number of possible combinations of pricing, bundling, and distribution options. This can lead directly to some of the pain points identified in the survey: inaccurate forecasts and reporting based on confused tracking of existing sales, and manual processes required to clear up confusion with orders and invoicing, and collections disputes over confusing or conflicting invoices and billing.

This can also create chaos with a traditional order and invoicing approach, with multiple cancelled invoices and new invoices produced with every change, leading to frustrated customers, subscription terminations, and collections difficulties.



As recurring business models require collaboration between multiple departments, it's important to leverage systems and processes that work seamlessly together.

To remedy these challenges, finance and sales must look at their current systems to determine the best way to maintain financial controls while also supporting dynamic contracts and maintaining sales speed and agility. As recurring business models require collaboration between multiple departments, it's important to leverage systems and processes that work seamlessly together. When making a transition to recurring revenue models, if businesses simply optimize each individual step in the customer lifecycle they will create silos, complex integrations, or redundancies that limit scale and effectiveness.

Conclusion

CFOs typically lead their companies' transitions to recurring-revenue/subscription-based business models, and finance enjoys several advantages under the new model. More financial controls, and better controls, are possible, along with compliance improvements, more reliable and real-time data for decision making, more predictable revenue, and improved valuations because investors like the model. It is critical for CFOs and their finance teams to coordinate with sales and sales leadership to solve the challenges that arise under recurring-revenue/subscription models.



ABOUT THE SPONSOR

Salesforce, the global CRM leader, empowers companies to connect with their customers in a whole new way.

Salesforce CPQ & Billing enables companies to adopt new business models, build recurring relationships with their customers, and make smarter business decisions by unifying Sales & Finance on a single platform.

For more information about Salesforce (NYSE: CRM) visit: www.salesforce.com

