RECURRING REVENUE

IT'S VALUE ON BUSINESS VALUE

TOM BRONSON

You may already know what recurring revenue is, but what does it mean for you and your business? First, recurring revenue sources increase your business's valuation and keep company cash flows flowing well... flowing.

WHAT IS RECURRING REVENUE?

Let's start with the basics, what is recurring revenue? Recurring revenue is a type of revenue that a business can reliably predict because it is generated regularly, typically from contracts or ongoing labor. This type of revenue is attractive to business owners because it provides a steady stream of income that they can count on to help plan for the future and make critical business decisions.

WHY YOU NEED RECURRING REVENUE?

No recurring revenue puts your business at risk because it relies on one-time sales or short-term contracts to generate income. This model makes it difficult for the business to make plans and allocate resources effectively, as it may need a clearer idea of how much revenue it will be able to generate in the coming months or years.

Additionally, not having recurring revenue can make a business more vulnerable to economic downturns or changes in consumer demand, as the business will not have a stable stream of income to fall back on. **Finally, one of the most important issues is your business' sell-ability**. A business with recurring revenue is more attractive to investors and potential buyers. The perception is that your business is less stable and less able to generate consistent financial performance over time. Buyers love predictable revenue. So do I. So should you.

Make your Business More Valuable

Past performance of a business is significant in determining its value. However, buyers ultimately purchase future cash flow, not past cash flow. Having streams of recurring revenue makes your business more valuable:

- It shows investors and potential buyers that the business has a stable customer base committed to using its products or services long-term. Recurring revenue increases the perceived stability and predictability of the business's financial performance, making it more attractive to potential investors or buyers.

- Recurring revenue can help smooth out the ups and downs of a business's financial performance, making it more attractive to investors or buyers looking for a stable investment opportunity.

- Recurring revenue can provide a steady source of income that funds growth or other investments, increasing a business's value.

MASTERY PARTNERS

The best way to show predictable future revenue is to convert as much business as possible to recurring revenue. Business Owners can convert most revenue into recurring revenue. Here's one example of how I did this in my own business:

In 2004, traditional purchase options dominated the restaurant technology industry: software, hardware, and services purchased or leased upfront. We started experimenting with recurring revenue by converting some of those upfront services into monthly recurring payments. By 2008, this experiment was standard operating procedure and running strong. Now, switching to this model forced us to raise some capital to carry the upfront costs (mostly hardware)and delayed profits. But, by 2018, our recurring revenue was 70% of our business - up from 4% in 2001 when we started the business. We were able to successfully sell that business because the buyer loved it.

COMMON FORMS OF RECURRING REVENUE

Now, what types of recurring revenue would work for your business? Are there any types of revenue sources that your business needs to be utilizing? There are several common forms of recurring revenue that businesses may use:

SERVICE CONTRACTS

This very common type of recurring revenue involves providing ongoing services to clients for a set fee and usually consists of a contract with you and your clients. There is a specific timeframe and a cancellation fee included in this contract. In most cases, the contract ends, and the client keeps using the product month-to-month. It is very common in industries such as IT, landscaping, and cleaning.

RENTALS

This type of recurring revenue involves charging customers a recurring fee for the use of a product or space, most common in industries such as real estate, storage, and equipment rentals.

SUBSCRIPTION-BASED SERVICES

Commonly known as SAAS, involves charging customers a recurring fee to access a product or service, most common in industries such as software, media, and fitness. Think Netflix. Or most subscription services. SAAS models result in greater client retention. This model is standard in retail, recreation, and personal development industries. Business owners are very familiar with this type of recurring revenue.

A couple of add-ins to this model are the subscription by user billing or the per-user, per-seat model, where the user is billed based on the number of people using the product. This type of recurring revenue model works so well that there are now companies whose whole purpose is to help you manage your automatic subscription renewals. In 2012, Adobe switched its Creative Suite to a cloud subscription service. This one decision not only improved their annual income but widened their customer base because it made their excellent products available to small business owners - which also increased their revenue.

Membership-based models

The customer buys a product or invests in a platform and then makes recurring purchases to be able to have perpetual use of the product or service. Think Amazon Prime. You have to pay for your membership to access the platform and then you have access to in-app rentals and purchases. Usually, with this model, businesses usually automatically charge clients until the customer withdraws from using the service.

LICENSING

This revenue stream involves charging customers a recurring fee for the use of intellectual property such as patents, trademarks, or copyrights, most common in software, media, and technology industries.

Businesses sometimes bill this brand of recurring revenue through multiple tiers of pricing based on the level of use. Once your client exceeds the allowed consumption quantity in one tier, they upgrade to the next tier for more features, functionality, and consumption quantity. Think of any CRM (Customer Relationship Management system).

A popular recurring revenue implementation tactic, called a freemium, is where customers have free lifetime access to the basic product or service plan but then upgrade to paid plans for more advanced features. Think Mailchimp or Monday.com.

GROWING YOUR BUSINESS

Once implemented, the recurring revenue models compound your sell-ability with buyers when you are ready to transition your business because it bleeds over into other value-creation metrics buyers want. Here are a few:

SOLID CUSTOMER BASE

This very common type of recurring revenue involves providing ongoing services to clients for a set fee and usually consists of a contract with you and your clients. There is a specific timeframe and a cancellation fee included in this contract. In most cases, the contract ends, and the client keeps using the product month-to-month. It is very common in industries such as IT, landscaping, and cleaning.

STEADY REVENUE STREAM

As we said earlier and will say ten more times throughout this eBook, predictable revenue at scheduled intervals makes you run a better business. Everything (budgeting, sales growth, uncertain times) is much easier to manage when you aren't in survival mode worrying about making payroll or if that client is paying their past-due invoice.

INVESTOR CONFIDENCE

Investors are easier to find and get with predictable revenue flow. If you want to grow and expand, you will need investors

WHAT THE BUYER SEES

Put yourself in the buyer's shoes. Here are some ways a buyer reads a business with low monthly recurring revenue (MRR).

A business with a low MRR could

- potentially be more affordable to purchase. (This means a discounted business value.)
- have more room for growth, as there are more potential opportunities to increase revenue over time. (This requires work from the investor, which means a lower value for the business.)
- indicate that the business has reached its maximum potential and can only grow with significant capital and time investments. (Unattractive or past prime business that the buyer will be hesitant to move forward with unless they buy your business at a lower valuation.)

- be riskier, as it can be more vulnerable to changes in consumer demand or economic conditions. (This means you are not a good option for a buyer.)

- require more investment to grow and stabilize itself, which can be a concern for investors or buyers looking for a more established business with a proven track record of success. (This means they will lower the selling price to compensate for their effort and resources.)

MASTERY PARTNERS

The buyer is going to be looking for a business that already has steady streams of recurring revenue and isn't going to want to take a chance on one without it. Businesses that already have a sustainable MRR are valued higher when the owner is looking to sell. Not only are they valued higher, which translates to more dollars when you sell, but the odds of a successful sale increase monumentally with a recurring revenue model.

Recurring Revenue is Necessary for your Exit Strategy

Recurring revenue is important for a business's value because it provides a stable and predictable source of income, making the business more attractive to buyers and investors, as it reduces the risk that the business will experience sudden drops in revenue.

Recurring revenue can also help a business grow and expand more quickly, providing a consistent funding source for new initiatives and investments while increasing the overall business value. Lastly, businesses with a high percentage of recurring revenue may command a higher valuation, as they are seen as more stable and less risky than businesses that rely on one-time sales. Why? Because recurring revenue is often more predictable and less susceptible to market fluctuations, making it an attractive source of income for investors.

BOTTOM LINE:

Don't wait for an existing recurring revenue model in your business. Figure it out. It takes time, but it is well worth the investment for your business now and when you are ready for that DREAM EXIT.

MASTERY PARTNERS

TOM BRONSON

Tom Bronson is a serial entrepreneur and business owner. He is currently the founder and President of Mastery Partners, Mastery Mergers & Acquisitions, and the Business Transition Summit. All three companies empower business owners to maximize business value and serve business owners in different capacities to help them achieve their dream exit.

As a business owner, Tom has been in your situation a hundred times and knows what it takes to craft the right strategy. Bronson is passionate about helping business owners and has the experience to do it.

Bronson also helps business owners personally by serving with Business Navigators as the Navigating for Business Success Chairperson. This servant leadership organization helps businesses through outreach, education, and community service. He is the voice of the Southlake Dragon Marching Band and a sought-after speaker who frequents many venues sharing his vast knowledge on various topics. Tom has just published his second book, "Maximize Business Value Playbook," (2023). The follow-up to his first book, "Maximize Business Value, Begin with the EXIT in Mind." Both are available on Amazon.

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