THE BEST PATH TO RECURRING REVENUE GROWTH

A MultiplyGTM Whitepaper

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Introduction

Imagine simply selling the same amount each year and yet experience continued revenue growth over time. You'd be crazy not to adopt this model given the opportunity, right? At first glance, this world of recurring revenue seems like a no-brainer and yet less than 10% of software startups make it through the scaleup phase.

So, what's the catch? The thing is, there are several interdependent **sources** of revenue in a recurring-revenue business that require different degrees of nurturing and focus depending on where your organization is in its journey. Focus solely on acquiring new customers, falling short on providing decent customer support and you'll stall, losing repeat business from your early adopters. Take too long to build a decent head of steam in terms of a user base and the amortized value of your subscription offering will kill your cashflow – you won't make it out of the gate.

How a business alters its emphasis on revenue sources over time influences its path to success and revenue growth. Recurring revenue offers great opportunity for us to be very successful but also exposes risk and high chance of failure.

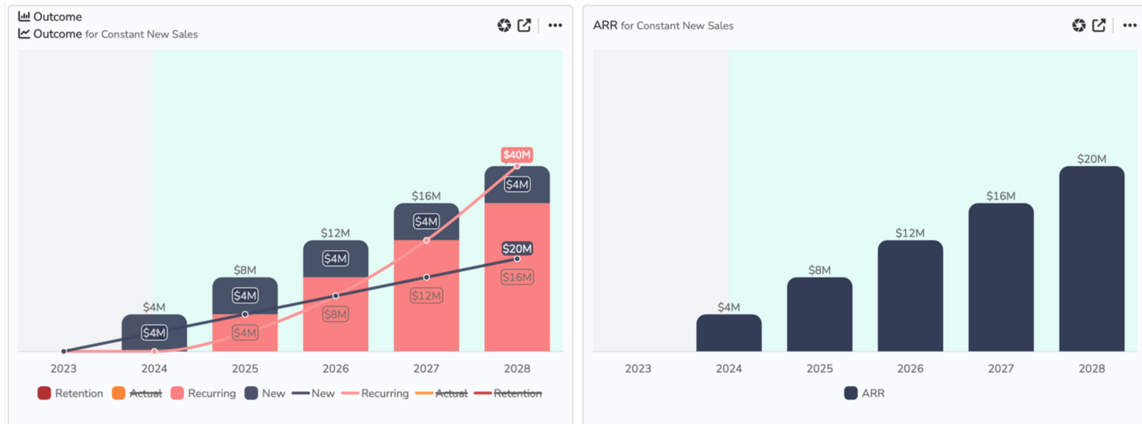
Focusing on the right source of revenue, at the right time, needs to be both reactive and proactive. Reactive change as a response to external environmental changes, like the emergence of a new competitor. Or proactive change driven from within, such as a simple desire to make more money. Knowing what to change and when to change has historically been more art than science. Thankfully, today art and science are converging with the help of revenue growth models and supporting analytics.

Revenue growth is not simply a matter of "sell more". Careful consideration to growth drivers needs to be given at all stages of an organization's lifecycle.

Primer on Recurring Revenue Models

Recurring revenue models are very different to traditional "one and done" or perpetual sales models. Instead of resetting your revenue number to zero at the beginning of each year, if you keep your existing customers happy and simply maintain your annual new sales revenue at a constant rate, you'll "automagically" double your revenue in your second year of business. Keep this up year-on-year and your revenue growth will just keep on growing!

No growth whatsoever in new sales and yet exponential growth in Annual Recurring Revenue (ARR). Pretty amazing, but only if you can sustain it.



Constant Sales with Increasing Recurring Revenue

Resulting 5 Year ARR Growth

In the example above, sell $4MM each year and by the end of year 3, your recurring revenue will outpace your new sales. Not only that, by the end of year 5, you'll be generating a whopping $20MM in ARR – now that's compounding!

This example, while mathematically correct, is hiding the Achilles heel of recurring-revenue. The grim reality is that there are multiple revenue sources that drive this compounding and each of these need nurturing and protecting along the way if you are to have a fighting chance of getting anywhere near the growth curve shown above.

The Four Sources of Revenue in a Recurring-Revenue Model

Let's first expand on the overly simplified concept of "new sales + recurring revenue = total revenue".

In a business that is already in-market, the first source of revenue comes from great work already executed in the past. Sales made in prior years results in repeated revenue in the form of what we call "**Retention**".

An old boss of mine used to start our January kick off meetings with "*even if we sell nothing new this year…we will still generate so many million dollars…*". This statement used to irk me but, in many ways, he was right – keep our existing customers happy and low and behold, we will generate revenue without even having to sell to anyone new! The key takeaway here is to make sure our existing customers are happy enough with our ongoing support to warrant them renewing their subscription revenue with us.

Now for the obvious one: let's consider "**New Sales**". New sales consist of selling offerings to a new client – someone we haven't sold to previously. This is where our traditional customer acquisition journey kicks in: marketing generates top of funnel leads; these convert to sales opportunities; sales opportunities become bona fide deals which then convert to closed won deals or customers. New sales revenue is an essential pillar in a recurring revenue model but as time progresses, it gets harder and harder to find new customers to sell your offerings to. Prohibitors such as market saturation or competition start to kick in and challenge your ability to simply keep selling to new clients. Knowing when a shift towards one of the other revenue sources is hard to determine.

The third revenue source to consider is "**recurring"** revenue. Repeat revenue from the new sales generated. While similar to retention sales, it is important to treat this revenue source separately as it is tied to the hip with new sales growth – it is linked to how much new sales you achieve. Conversely, retention revenue comes from good things already achieved in the past. Retention is largely dependent on keeping existing customers loyal and happy whereas recurring revenue is dependent on new customers successfully going through onboarding and seeing the value of their new investment beyond just the initial purchase year. The drivers that influence retention and recurring revenue are different. Think of retention revenue as historical revenue versus emerging recurring revenue.

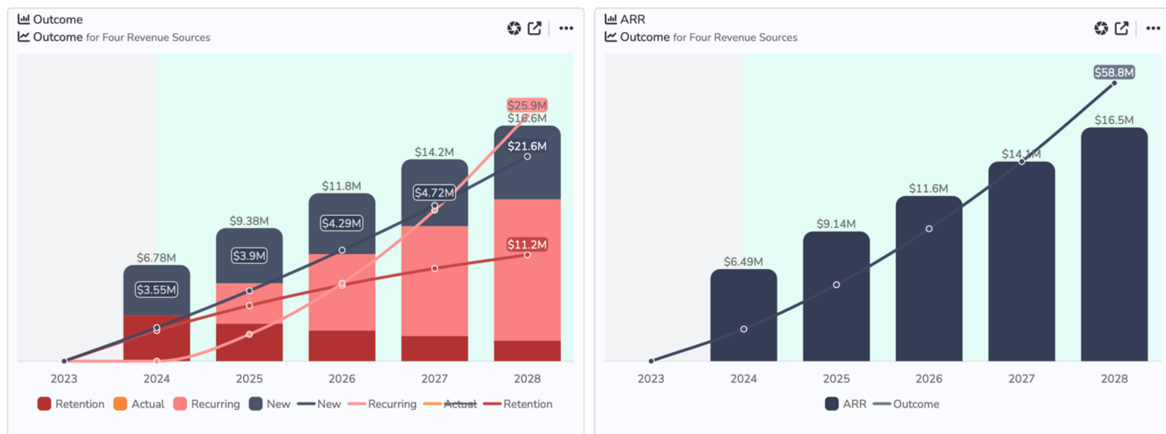
The fourth source of revenue comes from selling new offerings to your existing customers – "**expansion**" sales. Expansion sales involves a similar customer acquisition journey as new sales but, interestingly, is impacted the new offering you are trying to sell AND how happy the existing customer is with what you sold them previously! A customer's perception of the value of your solution and brand is a key driver of expansion sales.

The four sources of revenue are each influenced by different impact drivers, and each require a different type of effort to drive results.

Source	Impact Driver
Retention	• Existing customer loyalty
New Sales	• New customer acquisition journey efficiency
Recurring	• New customer onboarding & adoption effectiveness
Expansion	• Existing customer's perception of your solution & brand

Revenue Sources & Their Impact Drivers

The chart below shows typical growth curves for the various revenue sources. For the sake of simplicity, the new sales line includes new sales to both new and existing (expansion) customers.



Typical Revenue Source Growth Profiles

Retention revenue, at best, will be constant year on year reflecting a straight line. Typically, retention will suffer from some degree of churn. This can be seen in the red retention line above. Retention is slowly decaying because some customers choosing to not renew. This is having a small negative impact on the yearly ARR growth curve.

New sales are increasing year on year at a rate of 10% as shown by the blue line. This gentle polynomial curve is the feed for the recurring revenue source. New sales are important for the "now" but more importantly, they are the long-term catalyst for driving year-on-year recurring revenue.

The recurring revenue line (the pink line) is the true driver of ARR growth. As the chart shows, if you can limit your customer churn, then the power of compounding drives the recurring revenue line up exponentially. The steepness of the curve

reflects not volume of recurring revenue but rate of change of growth on overall revenue.

The net result of these revenue sources combined is a hypergrowth curve for our overall revenue (ARR).

Which Revenue Source and When?

Now that we know the different revenue sources, where should you focus your efforts on an ongoing annual basis to best drive revenue growth? The answer wholly depends on where you are at in your organization's lifecycle.

Stage	Timeline	ARR	Primary Revenue Source
Seed	1st Year	< $1MM	New Sales
Startup	Years 2-3	< $10MM	New Sales + Recurring
Scaleup	Years 3-6	<$50MM	Recurring + Retention
Grown up/enterprise	Years 6+	>$50MM	Expansion

Organization Growth Stages

In the **seed** stage, you are stilling trying to figure out what you need to be successful when you grow up – you are emerging from under a rock! You are trying to prove market fit and the need for your offering. You need to win customers. Focus HAS to be on proving out your offering and acquiring early adopters. You are starting from scratch and so by definition, there is no retention revenue to fall back on. Getting to your initial $1MM ARR is hard as you are relying solely on new sales as your revenue source. The benefit of compounding from the other sources doesn't yet play a role.

The **startup** stage is treacherous. You are trying to escape from this stage as quickly as possible – success is all about growth. How quickly can you scale up your sales? New sales then quickly spill into recurring revenue. The 2 or 3 years of startup is all about selling your offering to new clients and then keeping them happy. Use new sales to drive early stage recurring revenue. As a startup, you are unproven and so ensuring that customers stay with you is key.

Scaleup is equally hard but in a different way. You now have an established client base to the point where you may be getting close to maxing out on the total addressable market of your current product offering. To support continued revenue growth, it is imperative that you retain your customer base. Retention of your existing customers along with ensuring your new customers intend to renew next year is key to growth. The goal at this stage is achieving sustainable growth.

Enterprise organizations face numerous challenges. With magnitude comes complexity. The ability to react to change becomes harder and yet external change

can very quickly have a major impact on your business. You need to be resilient to external forces ensuring that your revenue growth is indeed durable. To help with this, **expansion** sales is key. Selling new product lines and services ensures continued revenue growth even in the face of flat new sales for existing product offerings or saturation of your original addressable market.

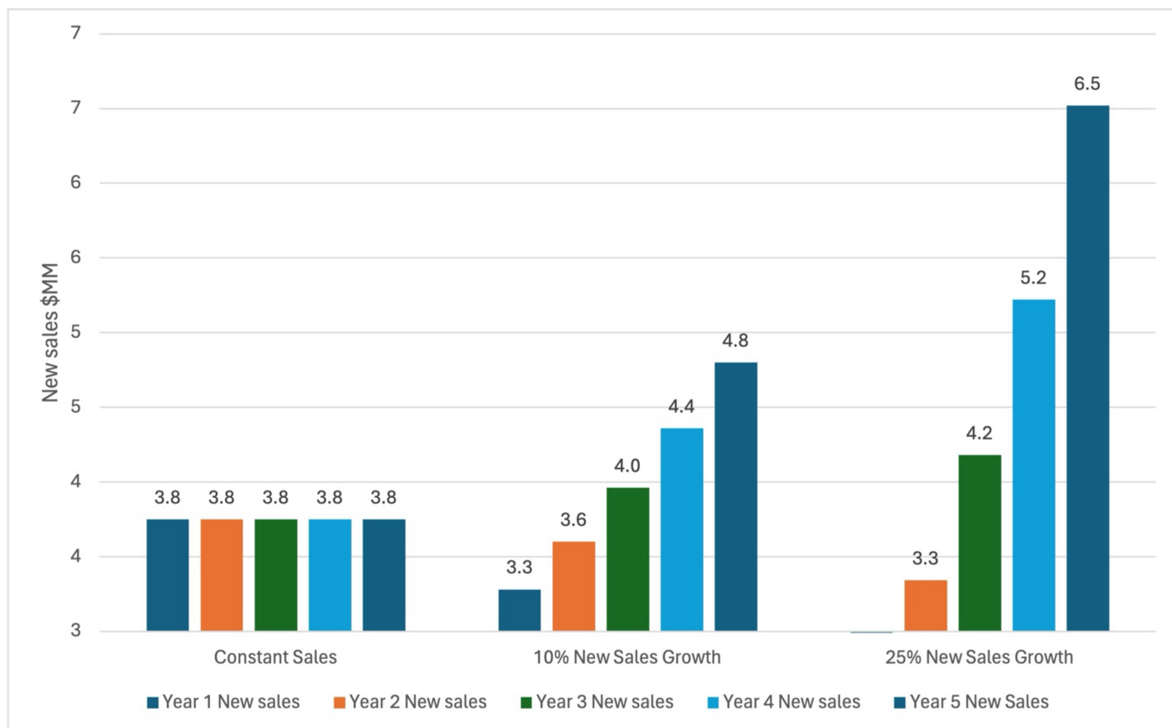
Build, Build, Build…

Sustaining strong retention and recurring revenue reduces the demand for new sales but this relationship is actually recursive. You need to have firstly established sufficient new sales to drive your retention and recuring revenues! What is so critical here is the dimension of time. In fact, timing drives your entire revenue model.

Let’s consider three revenue growth scenarios:

- 10% year-on-year new sales growth – our base model
- 25% year-on-year new sales growth – our stretch goal model
- Constant sales year-on-year – our pessimistic model

The 10% and 25% growth plans reflect us ramping up new sales over time. The constant sales plan assumes we will sell the same amount each year.



Three Different Growth Paths

By running our 5-year revenue model, we can determine the relationship between retention/recurring revenue and required new sales to hit our goal.

Scenario	New Sales Required ($MM)	Recognized Revenue ($MM)	New Sales % of Total Revenue	Additional New Sales Required
10% New Sales Growth (base)	20.0	44.8	36%	n/a
25% New Sales Growth	21.9	43.7	39%	10%
Constant Sales	18.8	45.6	33%	-6%

The results are perhaps not as obvious as we would think:

1. The more we sell up front, the less new sales revenue we need to generate. The compounding effect of gaining recurring revenue from more up-front sales lessens the need to sell more new customers. Build up an early head of steam and subsequently reap the rewards over time with the compounding recurring revenue source. Conversely, by pushing out our new sales projections to the later years, the less benefit we gain from the compounding effect over time of recurring revenue.
2. The more aggressive our growth curve, the smaller our recognized revenue number becomes. Ambition is a good thing but setting overly aggressive growth curves actually hurts our recognized revenue number.

In short, when considering new sales as a revenue source, try and front load as much as possible. Less for the benefit of gaining the initial $ win from new sales but more to help spur on the compounding impact of recurring revenue.

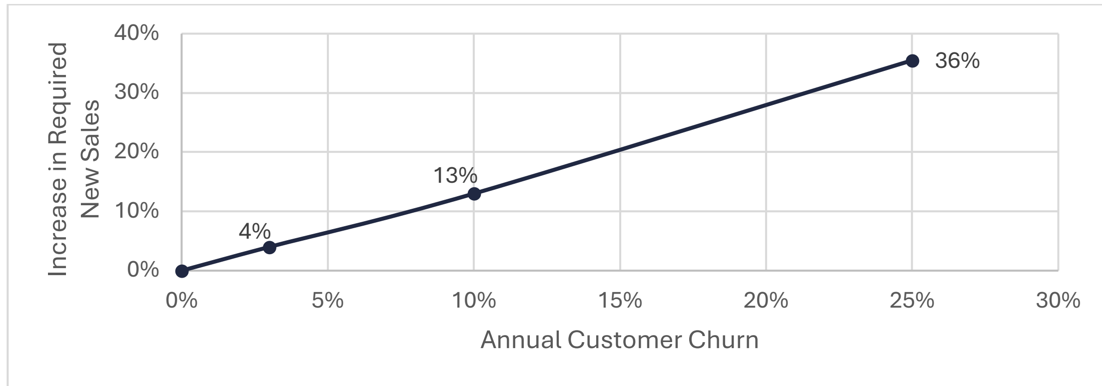
Retain, Retain, Retain…

Once we have built up a sufficient head of steam in the form of new sales revenue, our focus needs to shift to nurturing our retention and recurring revenue.

Retention revenue has one impact driver – it gets eroded via customer churn. Recurring revenue gets both enriched through new sales as well as eroded via customer churn.

The compounding impact of churn can be quite catastrophic and highly impactful on our need to backfill our goal with additional new sales. If we start to lose repeat customers, our efforts need to go back into generating more new sales in order to make up the shortfall. Sending us into a death spiral. Once word gets out that your customers don’t stick around, selling to new clients inevitably becomes harder and harder.

The chart below shows the disproportionate relationship between customer churn and the resultant increase in new sales required to sustain a given goal. A 10% annual customer churn results in a 13% increase in required new sales. With a 25% churn, this increases to 36%!

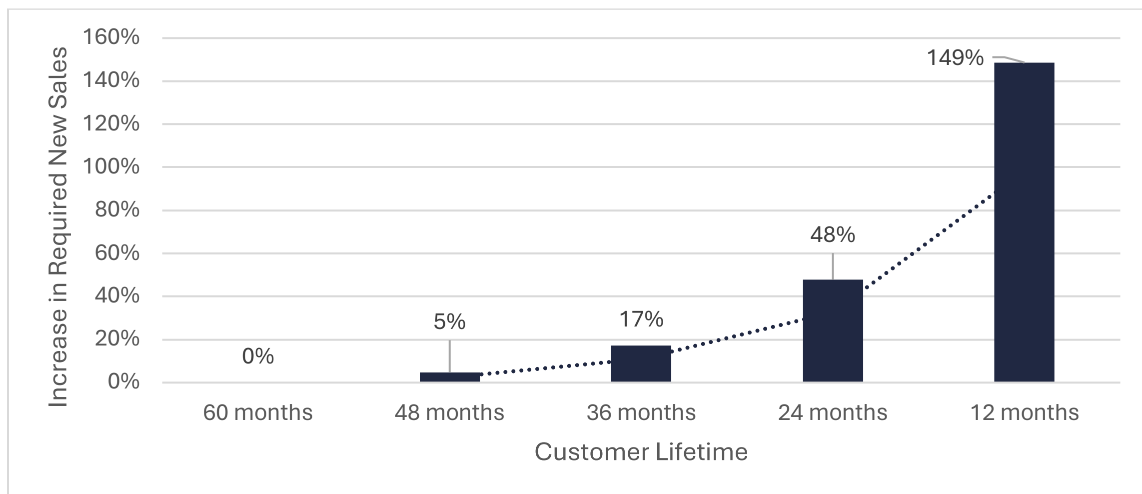


The Impact of Churn on the Demand on Required New Sales Revenue

The key here is to keep your churn well below the 10% level. Anything above this and your demand on new sales ramps up disproportionally.

Now let's add Customer Lifetime to the mix. Customer lifetime is a measure of how long an existing customer stays a customer.

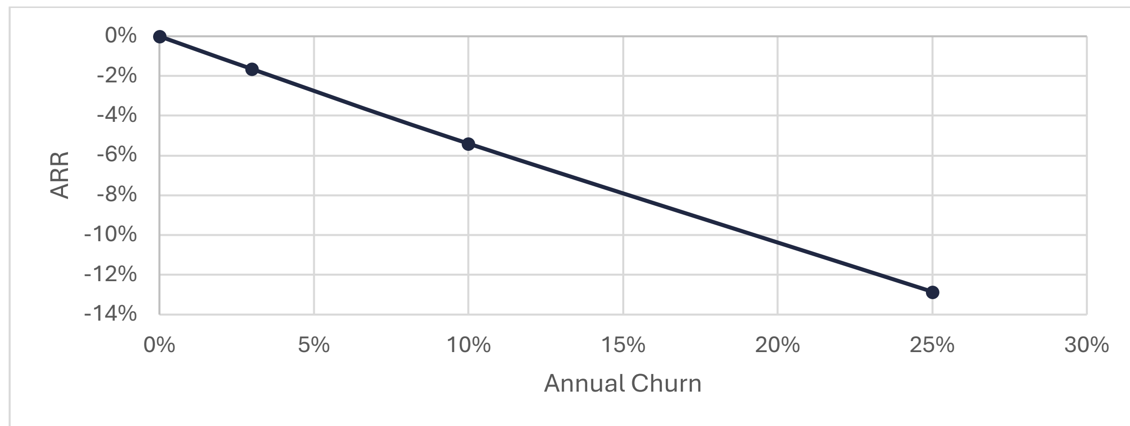
The less time we retain a customer, the more new sales we have to backfill with in order to hit our target. As we shorten our customer lifetime, the more we are driving the need to increase new sales growth.



The impact of Customer Lifetime on Required New Sales Revenue

Over a 5-year period, a drop from a 48-month to a 24-month customer lifetime, and the resultant need to sell more increases by 43% (from 5% to 48%).

Finally, let's consider the impact of churn on ARR. The chart below shows the dilutive impact of churn on ARR. ARR is a measure of predictable revenue at any point in time. Allow churn into your world and you run a significant risk of losing control over the predictability of your business going forward.



The impact of Churn on ARR

The key takeaway here is that while new sales revenue results in retention and recurring revenue, the efficiency of retention and recurring revenue actually drives the need for new sales.

There is a symbiotic relationship here. Both revenue sources need each other in order to survive. It is important that this symbiotic relationship is maintained as mutualistic (both benefiting each other) rather than running the risk of it becoming parasitic whereby the poor performance of one quickly hurts the other resulting in overall revenue growth decline.

Expand, Expand, Expand…

As we've discussed, new sales revenue drives retention and recurring revenue. Sustaining a solid retention and recurring revenue source, in turn lessens the need to sell more new sales. The net result is continued revenue growth.

At some point however, this self-perpetuating cycle breaks. There are only so many customers you can sell an offering to and despite your best efforts, you will lose some customers through churn, over time.

To satisfy the quest for continued revenue growth, there comes a point in an organization's lifecycle where focus needs to shift towards expansion revenue. In

simple terms selling new or additional offerings to your existing customer base. Expansion revenue comes from both up-selling and cross-selling. Upgrade an existing customer to a larger plan is a common up-sell. Selling them additional features or offerings is a common cross-sell.

The key to expansion sales is the cost efficiency at which you can potentially sell. It is common for the cost of a new sale to be greater than the initial up-front value of that sale. Conversely, an expansion sale will typically see a cost to value ratio of as little as 1:3.

The question of when to shift focus to expansion sales is tied to the growth curve of your new sales revenue. As previously discussed, the faster you can build up a head of steam in new sales, the greater compounding you will experience over time. The flip side to this is that the faster you saturate your addressable market, the sooner you will need to backfill with expansion sales.

Conclusion

Recurring revenue can be highly lucrative, but such opportunity comes with a high degree of complexity. The four revenue sources discussed in this paper (retention, new sales, recurring and expansion) all have different characteristics and are impacted by different impact drivers. Understanding these drivers is the key to ensuring each of these revenue sources perform to plan and at the right time.

The very close relationship between retention/recurring revenue and new sales revenue is paramount. Not only can they feed off each other in a positive manner, driving overall revenue growth, they also can quickly diminish each other leading to rapid revenue decline. Ensuring this relationship drives growth boils down to timing of new sales and then retaining these customers as long as possible.

Managing this complexity without using a dedicated revenue growth model is unachievable. There are simply too many impact drivers, variables, and potential paths in play for traditional spreadsheet math to be used.

That is why we built MultiplyGTM – the world of recurring revenue is simply too good an opportunity to mess up…