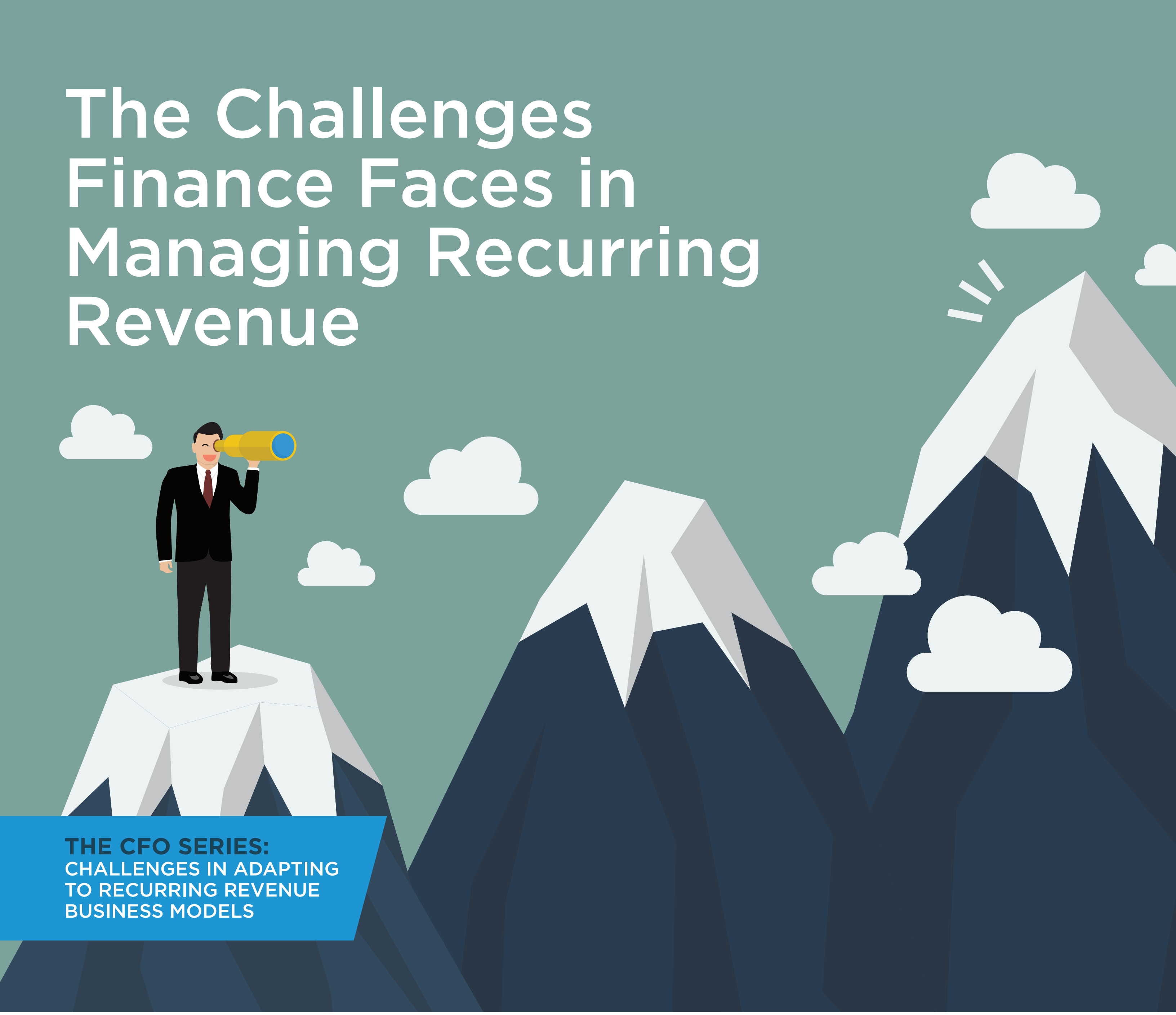
The Challenges Finance Faces in Managing Recurring Revenue



THE CFO SERIES:
CHALLENGES IN ADAPTING TO RECURRING REVENUE BUSINESS MODELS

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

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

A recent survey of senior finance executives by CFO Research and Salesforce 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.

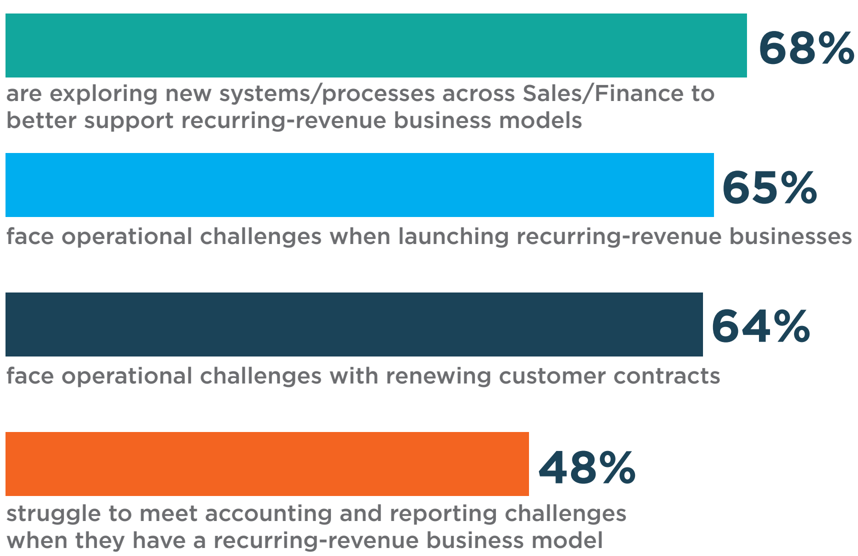
Challenges Galore

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



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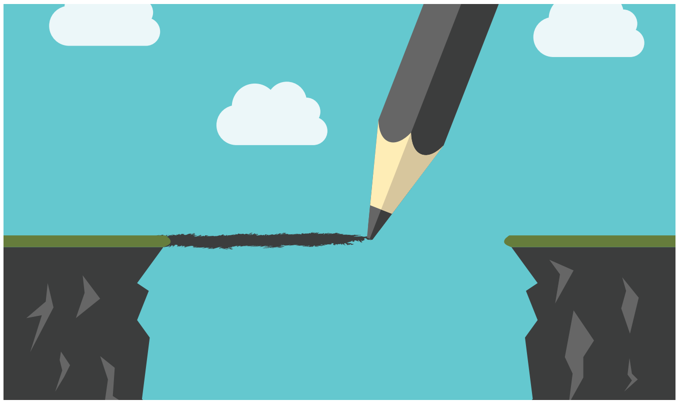

The CFO Research/Salesforce survey also shows that, of the companies launching recurring-revenue businesses, nearly two-thirds (65%) face operational challenges in doing so.

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.

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.

NEXT IN THE SERIES:

How better coordination between sales and finance can help solve the challenges of recurring-revenue business models.

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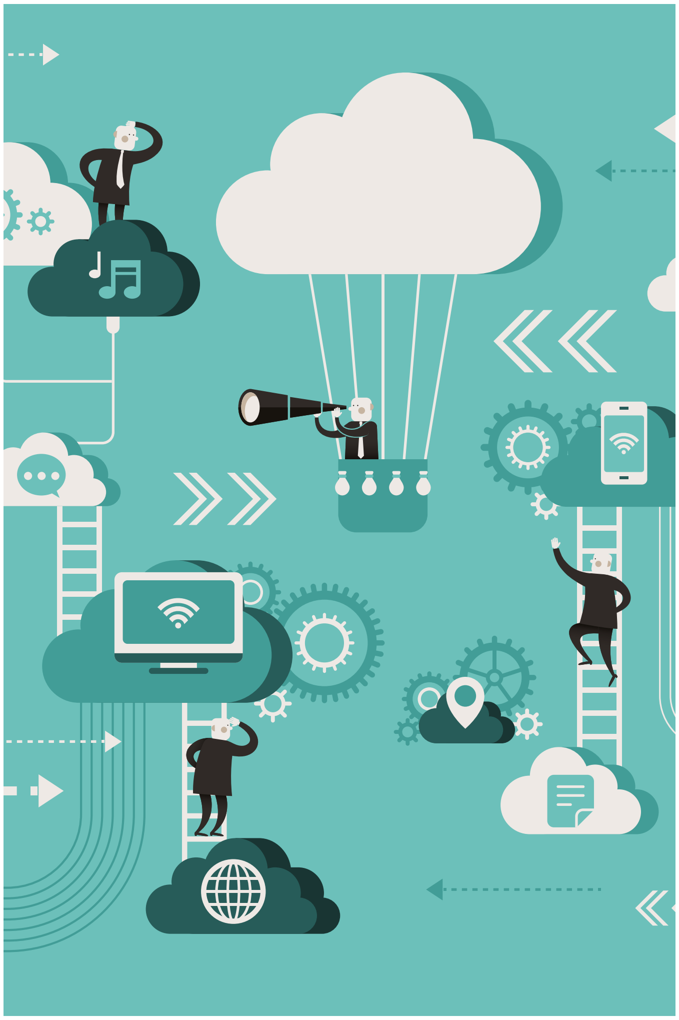

CONCLUSION

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 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.

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