The Operating Model for Recurring Revenue

The open standards outlined here can be applied to any recurring revenue business in order to drive sustainable growth, using scientific frameworks and data-derived models. Think of these frameworks as the formulas that help your Revenue teams move away from working as siloed functions of Marketing, Sales, and Customer Success, and instead become one Revenue team --- all using the same operating model, the same frameworks, the same language.

Jacco J. van der Kooij

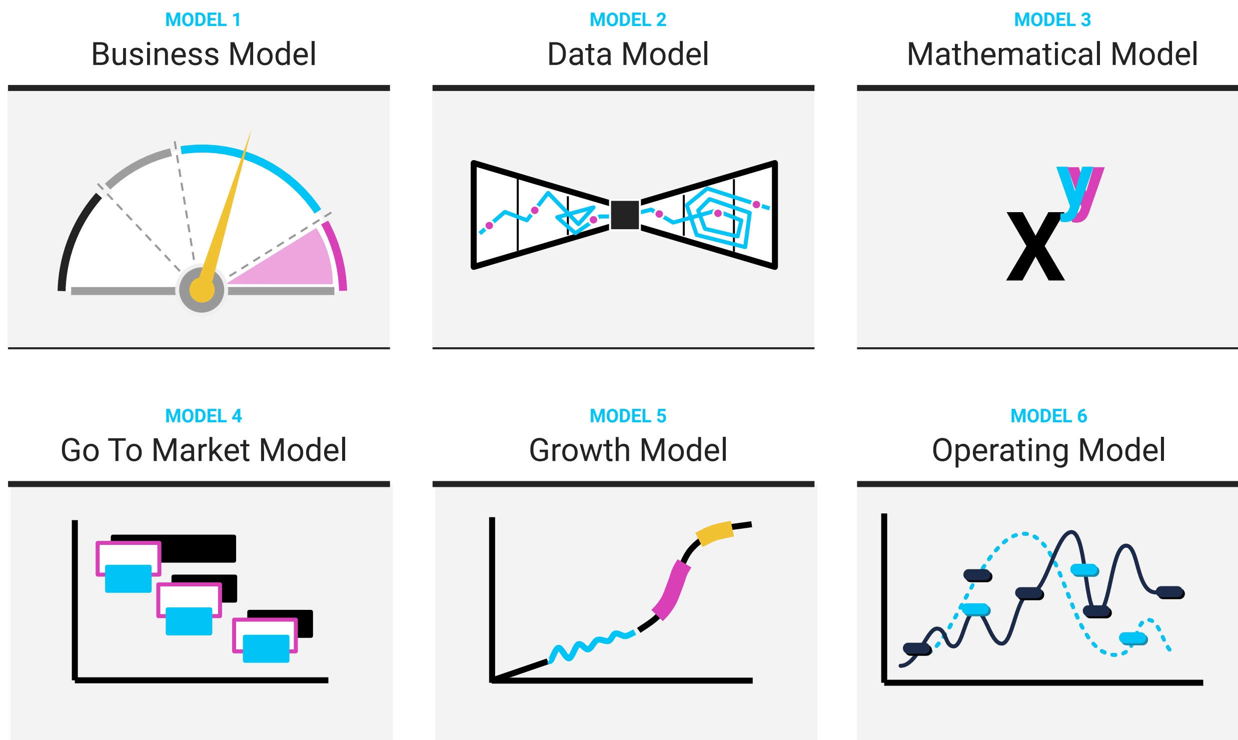
Founder, Winning by Design

June 2022

Summary Points

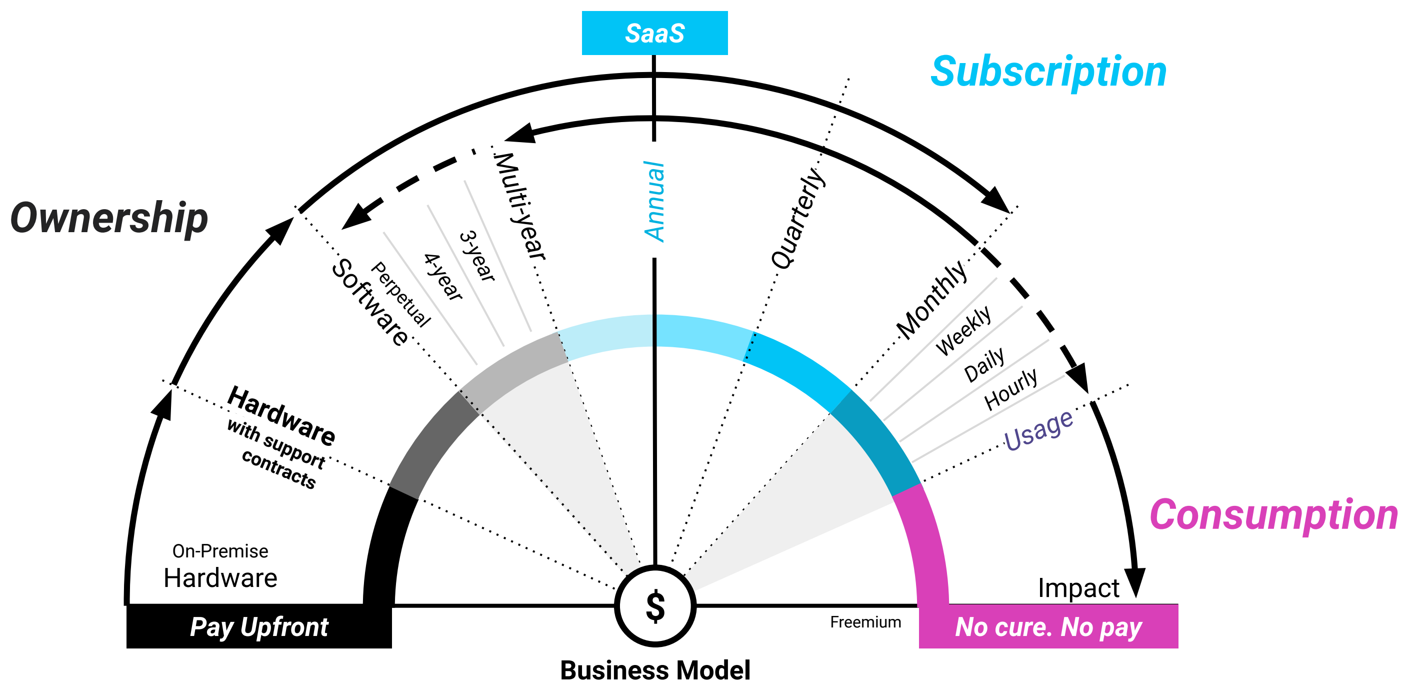
- The growth patterns of modern-day recurring revenue business models are unique from traditional business models; the typical 'sales funnel' framework does not apply to the unique needs of recurring revenue businesses.
- To achieve recurring revenue, companies must deliver recurring impact to their customers. A common operating system across Sales, Marketing, and Customer Success is needed to drive sustainable growth.
- The majority of the customer lifetime value comes after the initial sale, yet many leadership teams overlook the importance of CS motions in recurring revenue to successfully onboard, renew, and grow their existing customer base.
- Success in optimizing revenue and increasing productivity includes the alignment of all GTM teams to a common methodology, framework, metrics, and language, in order to deliver the best possible customer experience.

The Scientific Models that Govern Recurring Revenue



MODEL 1

The Business Model



Recurring revenue businesses can have a range of different business models, operating on an arc between two extremes: the 'pay upfront' model on the far left side, to consumption-based business models on the far right side. Each model along this arc has distinct implications for the sales cycle, win rate, level of risk, and go to market model.

Business Models on a Continuum

With the term 'recurring revenue', most people typically think of software sold on monthly, quarterly, or annual contracts, yet recurring revenue models actually exist across a much wider continuum. There are three types of models along this continuum:

- Ownership: The most extreme example in this category is where a company is selling on-premise hardware, where the buyer pays upfront (e.g., perpetual software license).
- Subscription: Most typical SaaS businesses fall in this category, often with monthly, quarterly, or annual contracts paid upfront.
- Consumption: This includes various forms of usage-based pricing; an example of this is pay-as-you-go cloud computing resources. (Footnote 1)
- Businesses can move from left to right, as well as from right to left, along this arc; doing so changes how the business should price their product, as well as how they sell it. It is crucial to be aware of these necessary changes, and the impact they have on the company's revenue operation.

Key Impacts of the Selected Business Model

Moving along the arc of this Business Model continuum from left to right results in the following key impacts:

- The sales cycle has accelerated. The length of the sales cycle tends to shorten as we move from a value-based proposal with an upfront payment, to impact-based performance with payment at the time of consumption. A conventional B2B software sales cycle for perpetual software license is typically 9-18 months, while the sales cycle of a SaaS contract with an annual contract value of around $50,000 is typically around 20-90 days. With consumption models, the sales cycle is practically instantaneous, with accounts often charged shortly after usage occurs.
- Win rates have fallen. Win rates for upfront contracts are typically quite high, as the buyer has generally already secured the budget internally; therefore, the win rate is about 1:3. With shorter SaaS contracts, the win rate is more often 1:5 or 1:6, because companies can usually test the product with minimal commitment required. Finally, in a freemium business model, the win rate is more like 1:8 or even less, because the commitment required from the buyer is even less, resulting in more unqualified buyers and higher churn.

The seller bears more of the risk. In a pay upfront model, the buyer bears the majority of the risk, as it's much harder for them to return the product and realign their organization around a new solution. As we move further toward subscription and consumption models, the seller instead carries the majority of the risk: their company has made a large investment in developing the software, while there is very little risk to the customer for changing their mind.

Trends in Business Model Transitions

Some growing trends of how businesses are shifting their business models are:

(i) Launching a SaaS product

A common trend among enterprises with a pay upfront model is to launch a new SaaS service that is aimed at capturing more market share and a more predictable stream. This often happens in the SMB segment, but may also happen in an enterprise business; one example is a hardware business that begins to sell a recurring support contract for the first time.

(ii) Selling to the Enterprise

In this scenario, an existing SaaS company that sells platform software to SMB and mid-market size companies will shift to selling multi-year contracts. This is typically due to the fact that their customer acquisition and retention costs are taking longer to recoup, and therefore a shift to longer-term customer commitments is necessary. This scenario typically occurs in large enterprises and educational institutions.

SaaS is not the only type of recurring revenue model; virtually any business can be a recurring revenue business.

Key Findings

FINDING 1.

In addition to driving retention, CS drives Recurring revenue is not exclusive to SaaS companies. The principles of recurring revenue apply to any business where they do not make a profit on the customer's first purchase, and therefore need to continue to sell and provide recurring impact to the customer over time.

FINDING 2.

Businesses can successfully utilize multiple business models at the same time. Businesses typically are successful when they rely on one model until around $10-20M in revenue, at which point they often expand and deploy additional business models to drive additional revenue streams.

FINDING 3.

The chosen business model has an effect on the sales cycle. As you move from perpetual to subscription to consumption, the sales cycle typically decreases from years (as in perpetual hardware contracts) to merely hours (customers paying as they go for cloud compute resources).

FINDING 4.

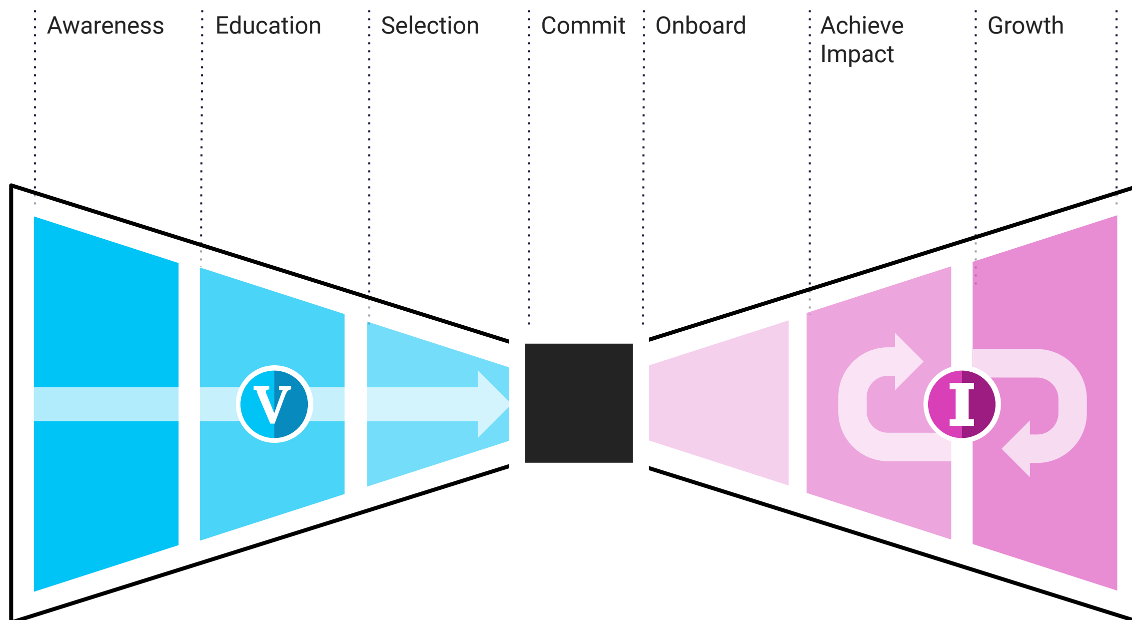
The chosen business model has an effect on the win rate. The win rate of qualified leads decreases moving from left to right in the business model. This is a result of the level of commitment that the customer needs to make in each scenario. This makes leads for a freemium business model the hardest to convert, because the customer needs to make very low level of commitment in order to engage with you.

FINDING 5.

The chosen business model has an effect on the level of risk. There are radical implications for the level of risk borne by the seller versus the buyer as you move across the spectrum of recurring revenue business models. As we move toward a usage model, the risk for the seller continues to increase, and the risk for the buyer becomes less and less.

MODEL 2

The Data Model



The modern Data Model for recurring revenue is represented as a bowtie, aligning all Revenue capabilities with a consistent set of metrics.

This contrasts with the typical 'sales funnel' or 'marketing funnel' that many Revenue teams historically have used to measure their performance across a sales process; that funnel has distinct shortcomings for enabling a recurring revenue model.

The Metrics

The Data Model for recurring revenue is comprised of three types of metrics:

(i) Volume metrics

Volume metrics are typically what revenue teams are most familiar with. These metrics often include measuring the following (or similar): prospects, MQLs, SQLs, SALs, commit (closed won), onboarded, ARR, and LTV. The exact metrics used will vary based on stage of the company (e.g., product-led growth companies with smaller contracts may be using monthly contracts, in which case they will focus on MRR rather than ARR). [Footnote 1].

(ii) Time metrics

The Time metric most often used by Revenue teams is the length of the sales cycle. Others often measured are time to go-live and average length of contract. For a more sophisticated, granular view that can help pinpoint where issues are happening in the sales cycle, revenue teams should be measuring the average time between each sales stages, rather than the length of the entire sales cycle, so that they can determine which parts of the sales cycle need further improvement.

(iii) Conversion metrics

Conversion metrics examine how many leads or opportunities move from one stage to the next. There are a few classic metrics used by many Revenue teams, such as Lead-to-Opportunity and Opportunity-to-Close. But similar to the case with volume and time metrics, Revenue leaders should be examining these at a more granular level in order to diagnose where improvements should be made. After the customer commitment, teams typically look at overall churn level, but they should examine this more closely, instead looking at onboarding churn and usage churn, which will typically have very different rates. Similarly, in the area of customer upsell, CS leaders should be looking at this on a more granular level as well, by measuring renewal rate (to the same decision makers), resell rate (to new decision makers), upsell rate, and cross-sell rate.

An important note that becomes clear when Revenue leaders start to visualize and apply the Data Model is that there is a strong emphasis on detailed Customer Success (post-sale) metrics, beyond what most companies measure. The reason for this is that improvements in the customer success stages of a recurring revenue have a compound impact on revenue. For more information on compound impact, see here.

The Principles

Full Funnel

The typical buyer's journey that a B2B customer goes through is often thought of as the general phases of awareness, education, and then selection of the right solution for their business. Similarly, the typical sales process that B2B Revenue teams use to work with their customers often focuses on those three phases. But once the customer makes their selection, that is not the end of the customer journey; it's actually the very beginning.

In this way, recurring revenue teams typically make the mistake of focusing primarily on their own sales process to get to the commitment from the customer, ignoring the rest of the customer journey where the customer is focused on achieving their desired impact. The sales process for a SaaS product may take just a few months, while the length of a successful relationship with that customer may last many years. Therefore, rather than a narrowing 'funnel' that ends with the customer commitment, the proper process and model for recurring revenue is far better represented by a bowtie, with the customer commitment in the middle.

Recurring revenue is the result of recurring impact.

Closed Loop

The modern Data Model, when properly applied, operates as a closed loop system, which means that there is a loop that feeds back into the beginning of the model in order to inform it and improve it over time. In this case, a classic example of the closed loop is determining who your best customers are in the later stages of the bowtie, and then feeding that information into the beginning of the bowtie, where your Marketing team can be informed of these customers and try to go find more prospective customers that are similar.

Customer Centric

There is a fundamental rule that drives sustainable growth for successful recurring

revenue businesses: recurring revenue is the result of recurring impact. Examining the idea of impact further, there are two kinds of impact: emotional impact (e.g., making a report easier to build, or giving a manager more visibility into the activities of their team) and rational impact (e.g., increase revenue or decreasing costs). Revenue teams must think in these customer-centric terms, truly understanding what impact their customers are trying to achieve. [Footnote 2]

This way of thinking should be reflected in the sales process as well. Many companies think in terms of prospects, MQLs, qualified opportunities. Instead, the sales process should be thought of in terms of the customer: expressing interest, engaged with us, committed to a solution, ready to activate, achieving recurring impact, and growing further to achieving maximum impact. When we start to use this customer-centric mindset and terminology, we start to act in the best interest of our customers, helping them achieve recurring impact, in turn yielding recurring revenue over time.

Key Findings

FINDING 1.

The typical 'sales funnel' or 'marketing funnel' does not serve the needs of recurring revenue business models.

FINDING 2.

The Bowtie is a more accurate way to model the inner workings of a recurring revenue engine and reflect the principles that define it.

FINDING 3.

Companies are placing an outsized emphasis on the first half of the Bowtie, leading to a heavy focus on winning more deals; most companies have a great opportunity for growth by more closely examining and measuring their metrics after the customer has made a commitment.

FINDING 4.

Most revenue organizations have plenty of data at their fingertips, but are getting lost when it comes to how to interpret it. This results in the incorrect identification of the problems, and therefore the wrong actions being taken to remediate the issues.

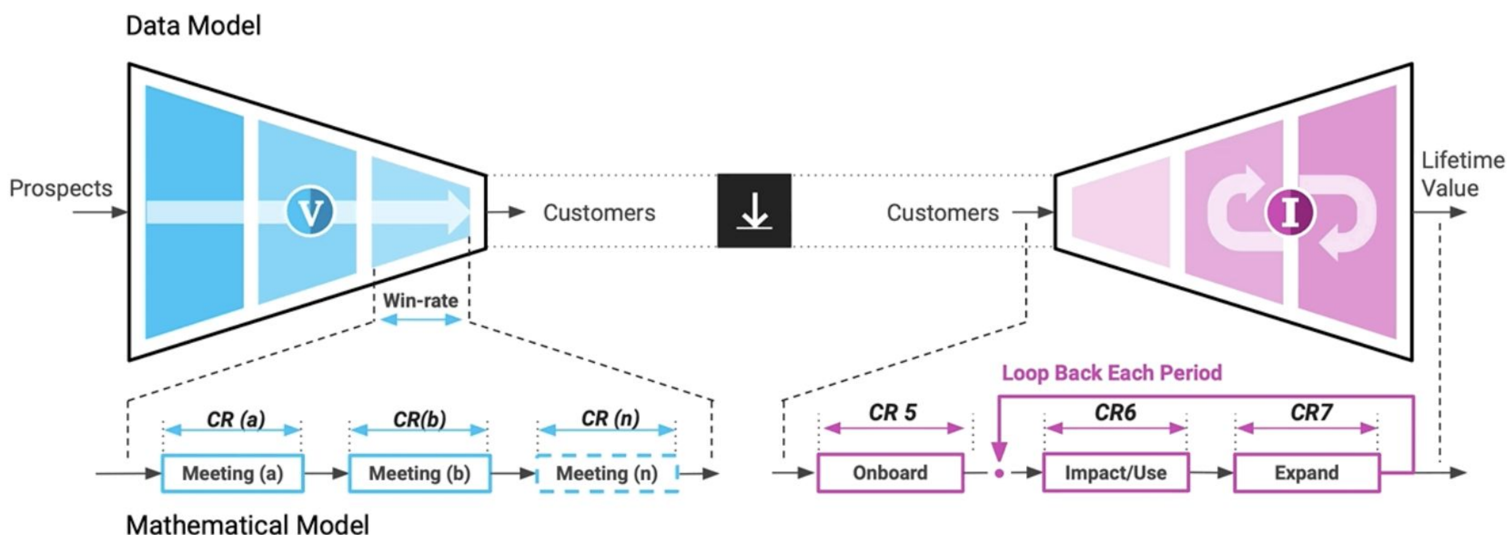
FINDING 5.

Recurring revenue models can be optimized as follows:

a) In the first half of the Bowtie, drive exponential growth by making small improvements at each of the key moments in the customer acquisition process

b) In the second half of the Bowtie, drive compound growth by making small improvements at each of the key moments in the customer success process (such as renewal, cross-sell, and upsell)

MODEL 3
The Math Model



The Mathematical Model shows that growth in a recurring revenue business is based not on linear mathematical principles, but on exponential arithmetic.

Reexamining the win rate

The win rate is typically determined as the number of wins compared to the number of opportunities. This is a linear function, and it implies that you need twice the number of opportunities in order to achieve twice the number of wins. However, this way of looking at win rate glosses over what actually happens during a sales cycle, and how those moments in the sales cycle can be improved to achieve the highly desired exponential rather than linear growth.

When we break the sales cycle down in terms of activities, we see the the sales cycle is comprised of a series of meetings. At each meeting, the customer determines if they are still interested in the product; if yes, a subsequent meeting occurs, and if no, the sales cycle ends there. In order to get to a win, each meeting has its own conversion rate; if a meeting 'converts', then the next meeting occurs. It then follows that the win rate becomes the aggregate of all of the individual meeting conversion rates. Continuing along these lines, the sales cycle becomes the aggregate of the time between all meetings.

The sales cycle can therefore be thought of as a simple mathematical formula, where the win rate equals the multiplication of each of the individual meeting conversion rates. Similarly, the win rate formula can also be thought of as the average conversion rate per meeting, raised to the power of the number of meetings --- which is an exponential relationship.

By thinking about the sales cycle in terms of the conversion from meeting to meeting, we then can start to see how small improvements can have a disproportionate impact on results. According to this mathematical formula, the two key ways to drive exponential results are (1)

decrease the number of meetings in the average sales cycle, and (2) increase the average success rate for each meeting. [Footnote 1]

> ***Growth in a recurring revenue business is based not on linear mathematical principles, but on exponential arithmetic.***

The true growth engine

It is a common misconception that the most important fuel for growth is new leads, opportunities, and closed deals; many organizations place a maniacal focus on these elements, while ignoring a much more powerful and efficient growth engine. Instead, the majority of the growth in a properly functioning recurring revenue business comes from the compound impact of existing customers, during their lifetime in their customer journeys as they go through the key moments of renewal, cross-sell, and up-sell.

Key Findings

FINDING 1.
Recurring revenue models are built to take advantage of exponential and compound growth; organizations need to build their revenue functions with these principles in mind in order to maximize their growth potential.

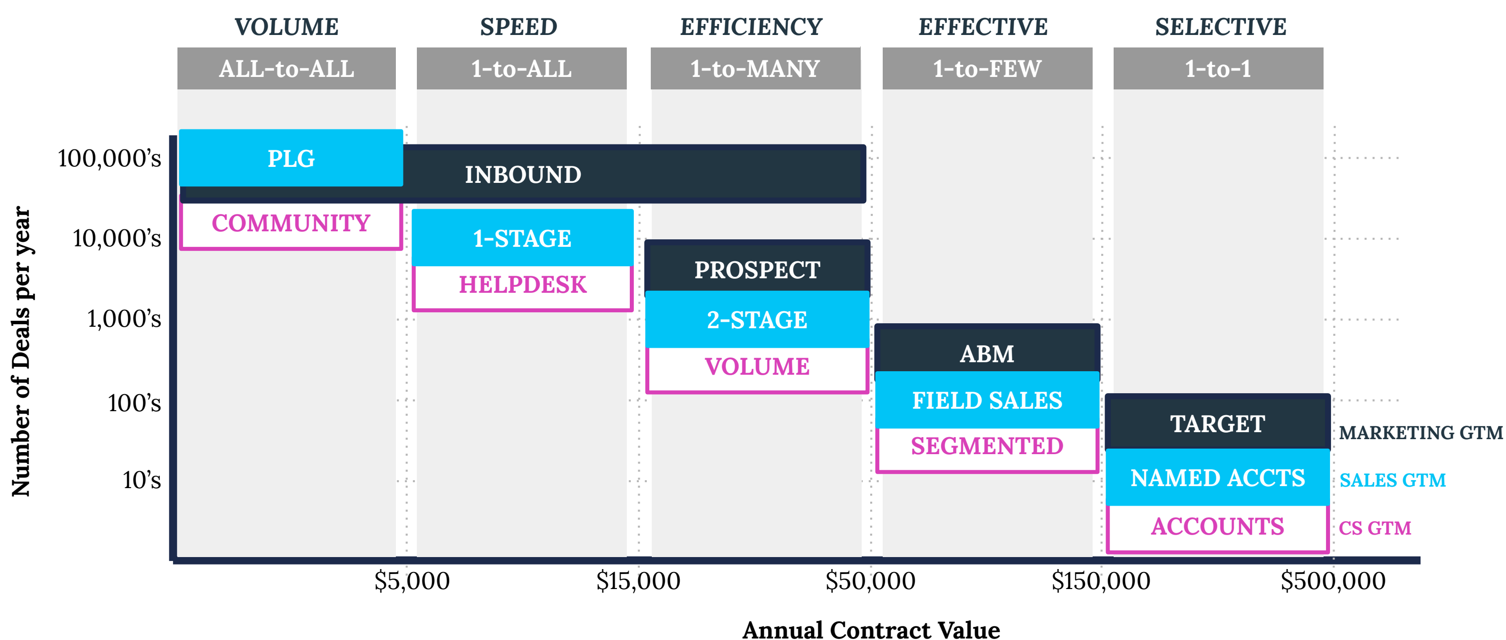
FINDING 2.
Disproportionate impact comes from the compound growth of existing customers.

FINDING 3.
In practice, the number of meetings in the sales cycle can be reduced using asynchronous tactics, such as sending a proposal with a recorded video that can be provided to all stakeholders, as opposed to needing multiple meetings to get all stakeholders aligned.

FINDING 4.
Companies can deploy asynchronous selling techniques in order to accelerate sales cycles and increase win rates, in addition to realizing other benefits such as decreasing customer acquisition costs.

MODEL 4

The Go-to-Market Model



GTM models of Marketing, Sales, and Customer Success are aligned based on number of deals per year and ACV, in order to deliver the best customer experience at the right cost to serve.

Aligning GTMs across Marketing, Sales & Customer Success

The GTM Model shows how the specific motions of Marketing, Sales, and Customer Success can be matched and aligned, based on two key factors: 1) the number of deals sold per year, and 2) the annual contract value (in the first year of the customer's contract).

The GTMs must be matched in order to achieve maximum efficiency and growth.

Sales GTMs: These range from 'no-touch' to 'high touch'.

- Product-led growth: The product itself acts as the marketing and sales function
- 1-stage: Entire sales process is handled by one inside rep, from discovery all the way through to close/commitment
- 2-stage sales organization: Two roles manage the sales process (e.g., an SDR qualifies and hands off a lead to an AE) [Footnote 1]
- Field sales: Reps are located in region, and typically hold a few hundred accounts. They may be aligned by geography or vertical.
- Named accounts: Enterprise reps work on a short list of large enterprise accounts

Marketing GTMs:

- Inbound: Typically content, SEO, events, communities. These marketing materials and content are not highly targeted (i.e., 1:everyone)

- Prospecting: Sending tailored messages to segments of customers or personas, based on firmographics and/or persona characteristics (i.e., 1:many)
- Account Based: Targeting fewer accounts, but addressing more people inside that account (i.e., 1:few)
- Targeting: Contacting a very specific list of people with highly targeted messages that refer to each person's unique situation and pain points (i.e., 1:1)

Customer Success GTMs: These range from do-it-yourself to highly supported.

- Community: This is typically in the form of online forums where customers find support and answers for themselves.
- Help desk: Often a combination of bots and human support who are available to answer questions via a ticketing system.
- Volume: Accounts handled by CSMs, with each CSM handling hundreds of small accounts.
- Segment: Accounts handled by CSMs, with each CSM handling a particular segment of accounts (e.g., mid-market accounts, healthcare accounts)
- Accounts: Accounts handled by CSMs, with each CSM handling a very small number of large enterprise accounts

When we map the GTMs of Marketing, Sales, and Customer Success to the axes of number of deals sold and annual contract value, we can then see how the customer acquisition cost and the service the company delivers are being matched together. As an example, in product led growth, the customer wants a low-priced product delivered to them quickly; with named accounts, they are buying a high price point product, and likely expecting high-touch, custom service.

By applying GTMs in this way, companies can deliver the best possible customer experience, while spending an appropriate amount of money to acquire that customer.

Key Findings

FINDING 1.

Companies often have mismatched GTMs (e.g., using a two-stage sales process while relying entirely on inbound content); there is a need for companies to examine what their current GTMs are for each of the three functions, and to align them accordingly under one coherent strategy.

FINDING 2.

Multiple GTM strategies deployed too early on in the growth cycle of a company results in spreading resources too thin. Companies will often start to build out a second and third strategy (e.g., selling into SMB and jumping to sell into the enterprise), before having solidified their revenue stream in the original strategy, which can quickly lead to resource constraints.

FINDING 3.

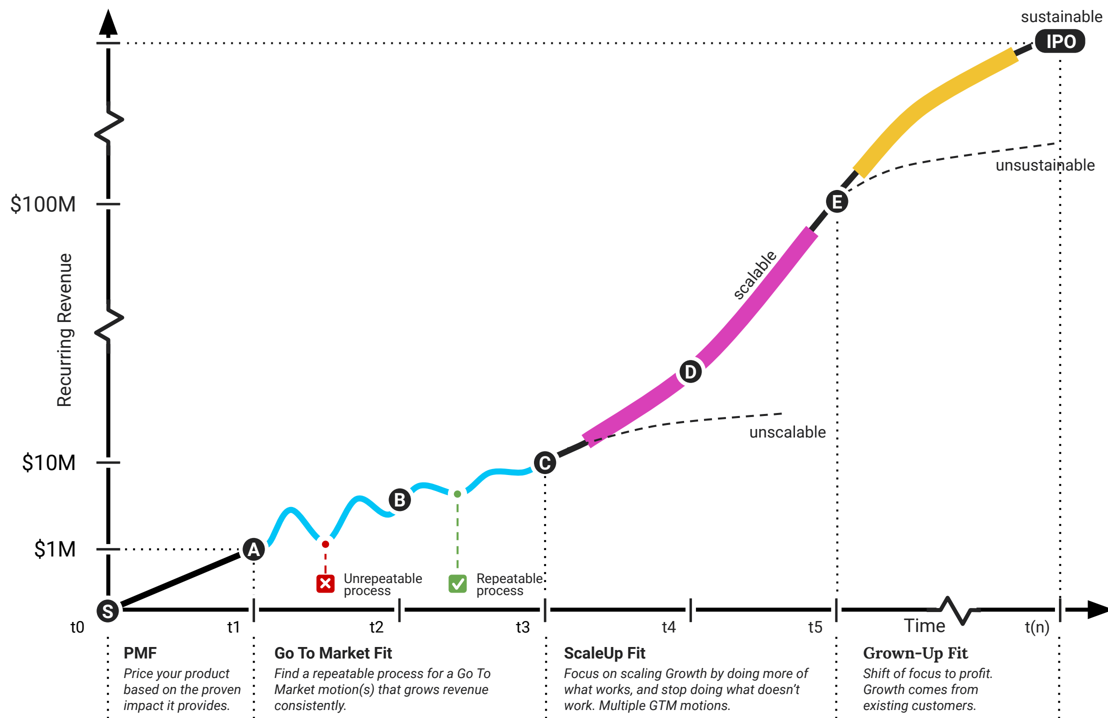
It is common for companies to move up- or down-market in order to grow; these movements typically take far longer than anticipated to fully execute. This is because the growth engines across GTMs are based on different foundations (e.g., the growth engine for enterprise accounts is expertise-based relationships and brand, while for mid-market accounts it is typically coming from events, content, and thought leadership; the growth engine for SMB is typically reliant on reputation, user base, and product ease of use).

FINDING 4.

The DNA of selling a product is very different from selling a service. At a lower ACV, customers typically expect to buy the product, but expect the service to be free (e.g., paying for premium 24/7 enterprise support for a software product). At a higher ACV, the customer typically buys the service, while they expect the product to be free.

MODEL 5

The Growth Model



This model is used to develop an understanding of what stage a business is in, and at what point it should move to the next stage to accelerate growth and scale.

The Stages

As growing companies move along the journey from starting up to scaling their growth, they go through a few key stages:

- Product-Market Fit: In this stage, the company is finding its fit with the market (e.g., determining the right price for the product they have built, for the market they are serving). The company has a high customer acquisition cost, as they learn more about their customers - what they are willing to pay, what impacts they are looking for - and adjust the product based on those learnings. Toward the end of this stage is typically when venture-backed companies raise a series A round of funding, in order to find Go to Market Fit as soon as possible.
- Go to Market Fit: In this stage, the company is now learning to sell its product in an efficient and effective way. Toward the end of this stage is typically when venture-backed companies raise a series B round of funding, in order to facilitate scaling going forward.
- Scale Up: In this stage, the company is learning how to grow and scale the business, applying what has been learned in the previous stage in order to accelerate growth.

Fundamental changes occur at all levels and facets of the company as it moves through these three growth stages. In particular, many founders make the mistake of thinking that the team and skillsets used in pre-revenue stages will be the same team and skillsets needed when the

company reaches the point of scaling.

This does not imply that a different team is needed at each phase. Team members can evolve and grow with the company, but founders must think about how to plan and recruit for current and future phases in order to supplement that evolution from the existing team.

The most common problem for Series B companies: 'Scaling failure' happens when not enough consistency in performance has been reached.

Generalized at a high level to illustrate this, the following skills and traits will be crucial and typical in each phase:

- Product-Market Fit: Self starters and proven superstars with reliable performance. May dislike process and structure. Will help to set the tone of the culture that the fonder is looking to establish.
- Go to Market Fit: Creators and builders who love to create a process and document what they are building. Able to listen and learn from what goes on around them, enjoying working with and learning from small teams.
- Scale Up: Dependable team performers who love to execute process. May need guidance and structure for creating new process, preferring structure that is already built.

Key Findings

FINDING 1.

Scaling failure happens when not enough consistency in performance has been reached. A frequent reason that companies fail as they progress through these stages is that they have not achieved enough consistency in the GTM Fit stage before raising more funding and starting to scale; they are scaling inconsistent results, and therefore the company is scaling failure along with success. Essentially, the company delayed reaching their true GTM fit and started scaling before that point was truly reached. This can often result in a 12-18 month delay in reaching the expectations that have been set by investors, as the rate of growth and efficiency needed cannot be sustained. A common outcome during this turn of events is that Revenue leaders are replaced, or that new levels of executives with experience at later stage companies are brought in with the intent of helping set the company back on the right path.

FINDING 2.

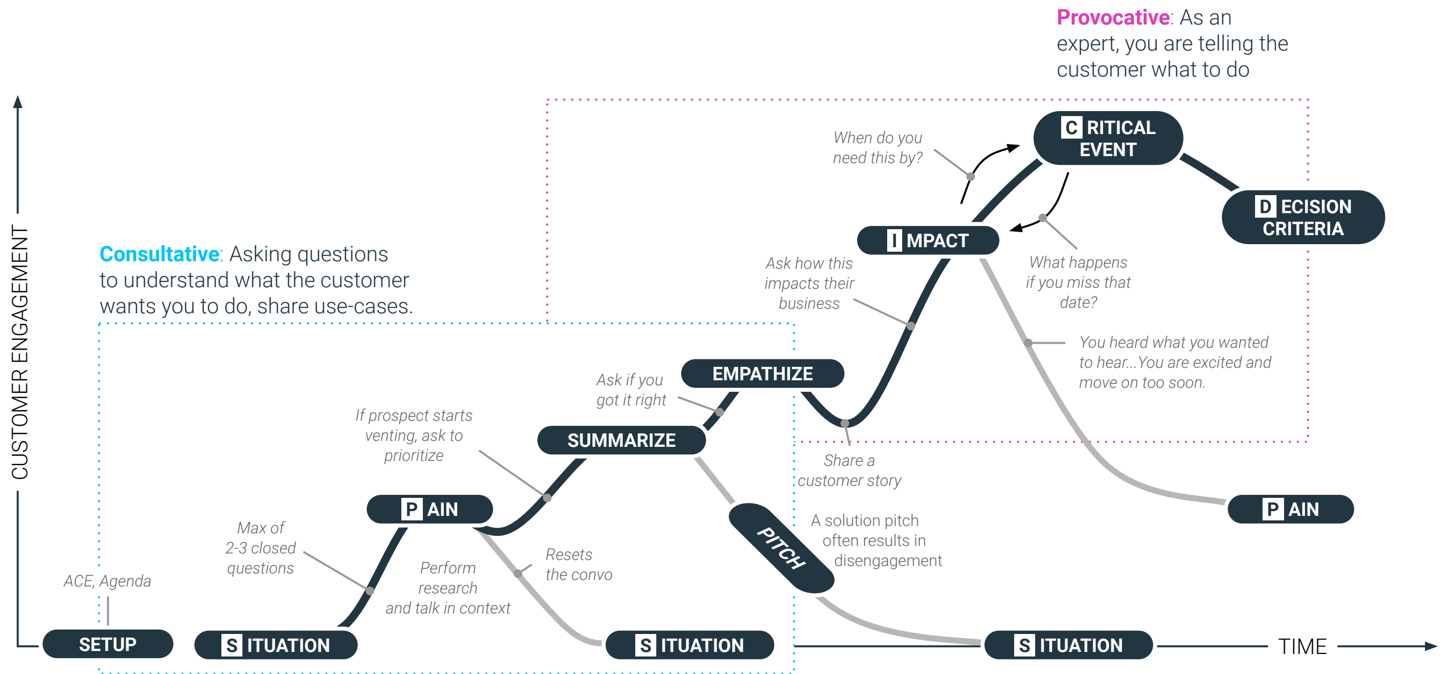
Launching a new GTM requires the company to reenter PMF and GTMF. The launch of a new product, entry into a new region, or selling into a new segment requires that a company, even briefly, reenters the product development cycle to establish product, price positioning, and GTM Fit. Another common failure point is launching a new enterprise product in the Scale Up phase in order to scale and grow revenue, without reentering that product development cycle.

FINDING 3.

Multiple GTMs deployed too soon will spread resources too thin. Company management will often have a tendency to deploy several GTM models before each one has matured and is scalable, with the goal of growing quickly and capturing as much of the market as possible. This error results in damaging the company's ability to scale, as resources are now spread too thin across multiple GTMs, products, and teams.

MODEL 6

The Operating Model



The Operating Model is a diagnostic framework for successful conversations and opportunities.

Issues with Sales Methodologies

Many sales methodologies have been developed and put into the market over the years, and they are very effective in bringing clarity and consistency to the sales process. However, there are a few common issues that occur with sales methodologies, which have become quite pervasive across Revenue teams:

1. Too many methodologies at once. Companies are employing multiple sales methodologies for different parts of the sales process. For example, BANT (budget, authority, need, timing) became quite popular in the Prospecting stage of the sales cycle in order to qualify leads before they were passed by SDRs to AEs. At the same time, several other methodologies are often used to help give structure later on in the discovery process. Revenue teams have ended up using several methodologies at once, but without being able to integrate these methodologies together. The result is a very inconsistent sales process that causes confusion between the functions of sales, marketing, and customer success, and a less than ideal experience for the customer.

2. Solution, consultative, or provocative selling? These are often taught as mutually exclusive, and teams will adopt one of the three based on what they feel is most complementary with the product they sell. A problem arises in actual conversations with customers, where salespeople often need to employ all

three of these methodologies in the same conversation --- pitching them on their solution (solution), diagnosing by asking questions (consultative), or provoking them with another viewpoint (provocative). Furthermore, these methodologies provide guidance on what needs to be accomplished, but without providing the step-by-step directions on how salespeople should go about it.

3. Methodologies do not integrate. Despite the fact that multiple sales methodologies are often used in the same sales process, Revenue teams end up misaligned across stages because methodologies were not built to integrate with each other. Each one has a slightly different focus, with different terminology, and different guidance on how to execute.

4. Helping forecast versus helping to sell. Most methodologies end up being utilized by sales managers in order to help them forecast, far more than they are used by individual salespeople to help them sell.

5. Methodologies focus on volume-based performance management. Methodologies tend to focus on helping reps win more deals (a focus on volume), rather than focus on helping reps with what they should do in their customer interactions (a focus on skills). Without that type of guidance, sales reps are forced to figure it out on their own and form their own habits, which may or may not be effective.

Revenue teams end up misaligned across stages because methodologies were not built to integrate with each other.

The SPICED Framework

By standardizing on customer impact, companies can overcome these challenges and align their teams to become customer-centric.

SPICED (Situation, Pain, Impact, Critical Event, Decision)is a diagnostic framework that provides the guidance for keeping the customer's desired impact as the ultimate goal, at the forefront of all conversations that occur during the sales cycle.

It allows for both a consultative and provocative conversation, where the seller asks questions to understand what the customer wants (consultative), and encourages the customer to think differently or see a different perspective (provocative).

- **Situation**. Facts or circumstances relevant to the customer that determine whether the customer falls within your ideal customer profile and what is happening in their world. Such as size of company, number of employees, software they use, hiring needs, security needs, or revenue goals.
- **Pain**. The problems the customer has purchased your product or solution to help solve. This could include the need to conduct training or recruit, support a global team, pass a security audit or stop errors to happen in a process.
- **Impact**. The results produced by solving pain. These are the outcomes the customer is trying to achieve by purchasing your solution. Impact can be

both emotional, for individuals, and rational, for companies.

- **Critical Event.** Any particular deadline by which to the customer must achieve the desired impact or suffer negative consequences. Critical Events drive the customer's timeline for a purchase. This is distinctly different from a compelling event, which does not have a specific deadline associated with it.
- **Decision**. The people involved in the decision, the process they will follow to reach that decision, and the criteria they will use to evaluate the right solution

Key Findings

FINDING 1.

More than one sales methodology is often applied at different points in the sales process; however, different methodologies do not integrate with each other, leading to confusion and inefficiencies across the sales process.

FINDING 2.

Methodologies are often confused with forecasting, and end up being applied so that managers have an easier time forecasting, rather than being applied to help clarify and guide the seller along the sales process.

FINDING 3.

Aligning all Revenue capabilities and the full revenue process is crucial for sustainable growth in recurring revenue; the unifying thread for this alignment is customer impact.

RESEARCH