

The Simplest Form Of Recurring Revenue Virtually Every Business Can Adopt

Recurring revenue makes your company more predictable, extends the lifetime value of a customer and ultimately makes your business more valuable. If you're unsure how to create these automatic sales, a simple service contract can be the place to start.

A service contract is an agreement to provide an ongoing level of service in return for a regular payment. It can be a way to transform an ordinary service company into a predictable subscription business.

For example, Walter Bergeron started a small company servicing circuit boards for large food processing plants. It was a classic service business where Bergeron offered his time to fix customer's circuit boards when they broke.

The business model worked fine, but cashflow was lumpy. Bergeron had reached a point where he could no longer sell any more of his time, and his growth stalled. Knowing something had to change, Bergeron made a 90-degree turn.

The Switch

He began offering a membership model where, instead of contracting him when a circuit board broke, he asked his customers to subscribe to a plan enabling them to have their circuit boards serviced at any time in return for a fixed monthly fee. Bergeron's customers paid monthly for access to his technicians when they had a problem.

The switch to a subscription billing model transformed the business, and Bergeron quickly grew the company to \$7 million in annual sales, at which point he sold it for \$10 million — a significant premium over a standard service company.

As the example of Walter Bergeron illustrates, most small businesses begin life using the "break/fix" business model where a customer has a problem, and you swoop in to provide a solution. This business model may make you feel valued as a problem solver, but it comes at the expense of the value of your company. In the break/fix model, you must create demand, sell your product or service, deliver it, and start all over again, which is why acquirers place a lower value on these transactional businesses when compared to subscription-based companies.

By contrast, with a service contract, you create an ongoing stream of income that has the potential to grow the lifetime value of a customer dramatically. When you can accurately predict how much money you will get from a subscriber, you can invest more in wooing them.

The most compelling reason to adopt a recurring revenue model is the impact it can have on your company's valuation. Dollar for dollar, recurring revenue can be worth more than twice that of transactional revenue, depending on your industry.

Service contracts are a simple and effective way to transform a transactional business into a recurring revenue goldmine.