



Start Building Recurring Revenue into Your Business Today

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When Jack Welch took over at GE back in 1981, he was handed the reins to one of the most innovative and diverse product companies of all time. Founded more than a century ago, GE expanded by selling a range of big-money products such as medical MRI machines, locomotives and jet engines. What's interesting, though, is that once GE sold a jet engine to, say, an aircraft manufacturer, the relationship essentially ended until they needed another, something that troubled Welch. He recognized that relying on a one-and-done business model was crippling the growth engine of the company.

Welch helped shift the mindset of GE from a company that sold products to a company that only sold bundles of products and services and established a long-term relationship with their customers. When GE sold a jet engine, for example, it also sold lucrative and recurring service contracts, spare parts supply and overhaul and financing services along with it. GE could afford to sell the engine at cost, knowing that it would earn its margin from the support services instead. Now, rather than watch their customers walk away after closing a deal, GE could count on receiving a steady, and profitable, revenue stream for as long as that engine was in service – a business model shift that powered the company's growth and profitability for a decade.

So what does this story have to do with your company? Sure, you recognize that recurring revenue trumps non-recurring revenue in every hand, since businesses with recurring revenue are more profitable, easier to run, easier to grow and provide a better and more stable work environment to its employees. But that's not the business model on which your business was founded. "If I had it to do all over again, I would have done it differently," you might say. "But now it's too late."

The story of 100-year-old GE proves that it's never too late to make the switch. While your company might not have the GE's deep resources, there are several different options you can consider to make a significant shift in your business on the fly.

The first step you need to take today is to stop digging the hole any deeper. It's amazing how many business owners settle for the status quo even when the future of their business is at stake. Just because you've always sold your products a certain way doesn't mean that you should continue doing it into the future. To be clear, it's a great thing that you successfully sold your products in a non-recurring way in the past. But, as you begin to introduce upgraded product versions 2.0 and 3.0, it's a perfect opportunity to do so in a way that takes advantage of recurring revenue.

Recurring Options

There are a number of options for how you can begin adding recurring revenue components to your product company today.

- Service Fees:

One straightforward way to add a recurring revenue component is to start servicing your products, post-sale. The mistake many entrepreneurs make is treating service as purely a customer support function, doing it free or below cost, as opposed to treating it like profit center. Offering service is not simply a disguise to take money from your customers. Your customers need service and you, as the maker of that product, are uniquely qualified to service it. By offering service, you have the license to charge fees for that service, similar to any other firm. Consider the example of an auto dealership. These businesses typically don't make a lot of money selling cars – it comes instead from performing brake jobs, oil changes and other major and minor services to the cars they sold. By coming up with recommended maintenance schedules, the dealers also found a way to remind and encourage customers to come in for service on a regular basis. Let your customers know that your product requires regular servicing to perform optimally, and that your company is best suited to provide it.

Not only can you offer to service your own products, you should also be expanding into servicing and maintaining your competitor's products as well. Doing so builds intimacy with your customer and gets you inside the tent. When your customer begins to think about buying a replacement product, you have positioned your company in the front of the line to provide guidance and compelling alternatives. You might even be able to recommend when they should replace an older competitive product. There is also the additional advantage of learning where your product might be ahead, or behind, in its feature set. Even if you learn that you have fallen behind, you can begin to catch up by learning the ins and outs of your competitor's product and incorporating those insights into your own product's design cycle.

- Maintenance Contracts:

At first glance, selling copy machines might not seem like the snazziest business model around. But, when you look closer, there is actually a very compelling lesson in recurring revenue to be found. Such businesses have extended and enhanced the service models offered by car dealers through their innovative use of all inclusive ownership contracts that include maintenance. Rather than simply sell products, such businesses lease their copiers and add fees that cover the ongoing maintenance of the product. If a customer is insistent on buying the copier, on the other hand, they will find that the cost of a typical service call outside of a maintenance contract makes for a poor economic choice. Not only are maintenance contracts a great way to build recurring revenue for your business, but they also guarantee that their product will be calibrated every six months and will be repaired or replaced if it breaks, all of which is covered in a single monthly payment.

- Training:

Another recurring revenue stream to consider is offering training fees for your product. This can be particularly useful to your customers if you make a product that is sophisticated or complicated to operate. This is a win for both parties since your customer will get more value out of the product if they fully understand how to use it and the offer will be stickier if they are getting full value. Again, you can also offer training services built around your competitor's products as a way to gain competitive intelligence and build your customer relations.

- Financing:

Building a recurring revenue stream out of financing can take several forms. For instance, you could offer your product on a lease-to-buy basis, where the customer pays you a monthly fee for three years until they take ownership. You can earn a margin on such a deal, especially if you can secure favorable terms from your lender. Let's say you can borrow money at 5% and then charge your customer 9%. You have then earned a 4% spread on the deal. This extra profit comes with minimal effort. You will likely increase your total sales as well if you can provide reliable financing for your product.

Some firms do not offer products for sale at all, as in our copier example, where you make your product available only through a monthly rental fee. The beauty of this approach is that there is no end to the payment stream. So, while paying down the financing, you will make the spread in the cost of money and the price of money. Once the loan is paid, the entire payment is profit to you. This is a particularly powerful approach if you have a balance sheet that can accommodate the lending. In other words, financing can be a very profitable source of recurring revenue and is often overlooked by entrepreneurs.

- Putting it all Together - Bundling:

Up to this point, we've discussed single line item approaches to adding recurring revenue to your business. The most effective and profitable approach, though, can often be bundling up maintenance, training and financing into an array of services, which you provide your customer for a recurring fee. That means that instead of selling your product for \$50,000 the way you used to, you can now charge \$2,500 a month for the guarantee that you will maintain the product, train your customer's people on how to use it and fix it if it breaks. By bundling, you have also combined the fees you earn on financing in a way that prevents your customer from going outside your relationship and attempt to borrow money on their own. By bundling, you have instantly created multiple recurring revenue streams from a single product and realized all of the income from multiple sources. You have also bear-hugged the customer relationship and made it hard for others to enter and displace you.

Making the Shift

At this point, you might be saying something along the lines of, "I love the idea of shifting to a recurring revenue business model, but... I'm not sure my customers will go for it." Making the shift from non-recurring to recurring revenue along the lines that we've discussed will indeed require effort to educate your customers about the benefits of the change. Your basic approach, therefore,

should focus on showing how, by handing the hassle of maintaining your product, you allow your customer to focus on doing what they do best. If you make the machine that produces their widgets, they can focus on selling those widgets rather than hiring their own employees to maintain it.

You can also demonstrate to your customer that your new service bundle will benefit their cash flow. Since they no longer have to allocate a big chunk of capital to purchase the product, they can budget their cash outflow with the cash coming in from their customers. Not only can that kind of cash flow be more profitable for them, but it also minimizes their exposure to market fluctuations in finance costs or changes in technology. Some firms will even offer a service bundle that ties directly to the use of the machine they produced. That decreases the more frequently they use the machine.

Unfortunately, no matter how much effort you put into educating them, it's likely that you will receive pushback from at least a few of your customers. If you face this hurdle, you can consider options such as splitting your customer base into two groups: one where people pay the recurring fee and the other that operates on your older, traditional non-recurring model. You can then make it clear that you intend to terminate your support of your older products after a certain period of time and service calls are going to be expensive. Granted, this approach takes some guts since it will require you to redouble your efforts at educating those customers you are resisting the shift. But, if you stick to your guns, you'll find that as more and more customers migrate over to your new offering, you've found a strategy to upgrade your business and your customer base over time.

Making the shift to add recurring revenue streams will also transform your business – especially when it comes to designing future generations of your products. In the past, your engineers might have been willing to take shortcuts in their designs or material choices because they knew a customer would be responsible for paying for repairs and defects. But, if your company is now responsible for supporting your products, you need to retrain your engineers to find ways that ensure your support teams aren't unduly tied up. Said another way, by taking control of the service of your products, you have brought your engineers into better alignment with your customers, as well as with your revenue model. The concept of total cost of ownership will have real power since your company will be fully exposed to the lifetime cost of operation.

In the end, building recurring revenue capabilities into your products is a good deal for both you and your customer. You will create better products; have a more reliable revenue stream and a tighter customer relationship. Your users will be able to focus on their business and have cash outflow that more closely matches their inflow. To get there, though, requires a significant mental shift by both parties. But the ability to make strategic shifts is what separates the great leaders and companies like Jack Welch and GE from all the rest. When it comes to your business, there is no time like the present to take the first step in that new direction.