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How Recurring Revenue Increases Business Value

By Jane Johnson (http://www.axial.net/author/janejohnson/), Business Transition Academy** | **February 2, 2017

When it comes time to sell their businesses, the first question that most owners ask is: "How much can I get?" It makes sense. Owners are eager to cash in and be rewarded for all of the hard work they have poured into their businesses over the years.

But the reality is that for many businesses, the initial valuation will be a much lower number than their owners want to see. In order to net enough from the sale (after taxes and fees) to fund the rest of their lives, most owners will have to work to boost the value of their businesses – sometimes significantly.

One great way to create value is to build recurring revenue into your business model.

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The Benefits of Recurring Revenue

Recurring revenue is guaranteed revenue for some period of time (for example, through a product subscription). Because this type of revenue does not require the same level of sales and owner effort as one-time revenue, it typically results in much higher profit margins and is always highly coveted by buyers. The evidence shows us that businesses with recurring revenue models have higher valuations than those that don't. In 2012, Adobe went from a one-time purchase model of its software to a monthly subscription model. Two years later, its market cap was $35.5B versus $16B – a 115% increase.

Examples of recurring revenue include:

- Service or maintenance agreements
- Consumable product or replacement part contracts

- Subscriptions for products, services, or information
- Memberships

Recurring revenue is stable and predictable income, and as such results in higher customer lifetime value. In addition, recurring revenue can help your business weather economic recessions and is likely to simplify your business operations in many ways.

Understanding the Value of Your Business from a Buyer's Perspective

Companies on a growth trajectory that can demonstrate increasing cash flows through new customer acquisition, current customer retention, and increasing market share are always much more attractive to a buyer than those that have shown little growth. Buyers want to know that revenue and cash flow are growing at a steady rate and will continue to do so in the future. And a recurring revenue model can be a great way to increase the value of the business in the eyes of a potential buyer. In *Cashing Out of Your Business – Your Last Great Deal*, we discuss 8 key drivers of business value that owners need to focus on before selling their businesses:

- Increasing Revenue & Profits
- Future Growth Potential
- Accurate Financial Statements
- Solid Management Team
- Quality Products & Services
- Strong Sales & Marketing
- Eliminating Business Risk
- Putting Systems & Processes in Place

Adding a recurring business model is one of the best ways to address a few of these value drivers, boost profits, and enhance future growth potential — thereby increasing the value of a business in the eyes of a prospective buyer.

Even well-established businesses can usually add some kind of recurring revenue to their model and reap these rewards. It may require that owners think "outside the box" or change how they have operated historically, but it will pay off in the long term. Buyers will pay more for quality companies and those that have growth potential.

By assessing your business objectively, you will be able to identify areas for improvement so buyers will see your business in the best possible light. Planning in advance will give you time to improve your business and maximize its value. As a result, you will improve your chances of selling and obtaining the highest price for your business.

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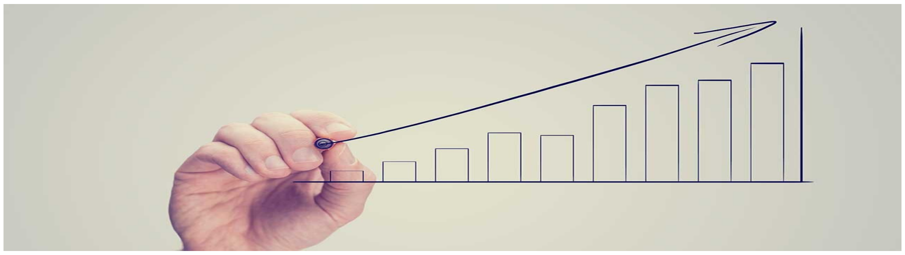
By Karen Sibayan** | **January 13, 2016 ()



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During negotiations in an M&A deal, buyers and sellers look closely at several factors in order to agree on a price that properly captures a company's value. One of the closely examined metrics in this process is EBITDA, which stands for earnings before interest, taxes, depreciation, and amortization. EBITDA is used as a way...

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