

THE HIERARCHY OF RECURRING REVENUE

How to make your company irresistible to potential buyers

Here is the hierarchy of recurring revenue presented from least to most valuable in the eyes of an acquirer.



NO. 6: CONSUMABLES (E.G., SHAMPOO, TOOTHPASTE)

These are disposable items that customers purchase regularly, but they have no particular motivation to repurchase from one seller or to be brand loyal.



NO. 5: SUNK-MONEY CONSUMABLES (E.G., RAZOR BLADES)

This is where the customer first makes an investment in a platform. For example, once you buy a razor you have a vested interest in buying compatible blades.



NO. 4: RENEWABLE SUBSCRIPTIONS (E.G., MAGAZINES)

Typically, subscriptions are paid for in advance, creating a positive cash-flow cycle.



NO. 3: SUNK-MONEY RENEWABLE SUBSCRIPTIONS (E.G., THE BLOOMBERG TERMINAL)

Traders and money managers swear by their Bloomberg Terminal; and they have to first buy or lease the terminal in order to subscribe to Bloomberg's financial information.



NO. 2: AUTOMATIC-RENEWAL SUBSCRIPTIONS (E.G., DOCUMENT STORAGE)

When you store documents with Iron Mountain, you are automatically charged a fee each month as long as you continue to use the service.



NO. 1: CONTRACTS (E.G., WIRELESS PHONES)

As much as we may despise being tied to them, wireless companies have mastered the art of recurring revenue. Many give customers free phones if they lock into a two or three-year contract.

When you put your business up for sale, you're selling the future, not just the present. So if you don't have a recurring revenue stream, consider how best to create one, given your type of business. It will increase the predictability of your revenue, the value of your business, and the interest of potential acquirers as they look to the future.