Introduction

We had been running together for five months when Sacha announced he was leaving on a business trip to China. The timing could not have been worse; the marathon was just six weeks away, and we had come to rely on each other to stay motivated through the hardest part of our training schedule.

Now, at the height of our work, he was leaving for two weeks.

Since Sacha and I wouldn't be able to run together, we decided to egg each other on digitally. We agreed to text each other the results from our training run each day as a way to stay motivated. Sacha asked if, instead of texting, we could use a messaging service called WhatsApp.

I was used to texting using the standard service on my iPhone, so I wasn't in a hurry to learn a new platform. I asked him why we couldn't just text the normal way.

Sacha replied that the phone company charges a relative fortune to text from China, and WhatsApp, instead of using the mobile networks, runs on the Internet and therefore doesn't require expensive mobile carrier fees. In fact, the only fee to use WhatsApp is a $1 per year subscription it charges after the first year.

We used WhatsApp to communicate while Sacha was in China, and eventually finished the marathon together, thanks in part to our WhatsApp–supported training regimen. It turns out that, in using WhatsApp, we were not alone. By early 2014, WhatsApp had acquired 450 million users and was adding a million users per day when Facebook announced it had acquired the company for $19 billion—the largest acquisition of an Internet start-up in history.

Most of the other Internet-based messaging services at the time used an advertising model to monetize their users. They offered a free platform but bombarded users with cheesy ads in return. WhatsApp founders Jan Koum and Brian Acton wanted to offer a cleaner, more private messaging experience. Instead of selling advertising, they opted for the subscription business model.

A dollar a year as a subscription fee may not sound like much, but when you have 450 million users and are picking up a million users a day, $1 a year starts to add up. What's more, because WhatsApp doesn't try to be anything other than a subscription-based messaging platform, it doesn't need a lot of employees. In fact, at the time of its acquisition, it had just 55 people taking care of its 450 million subscribers.

WhatsApp won the $19 billion lottery not because its technology was better, or its people were any more caring, or its advertising was funnier. WhatsApp won, in large part, because it made its customers automatic. It chose the right business model for success by asking users to subscribe to its service.

This book will show you how to apply the subscription business model to your own business. When people think of subscriptions, they often think of cloud-based software, gaming, or media companies. While readers from those industries will benefit from this book, you can also apply the subscription business model to your company—no matter what your size or industry. WhatsApp is only one example of how powerful automatic customers can be for the growth of your business.

I Screwed Up

The last time I wrote a book, I screwed up.

Called *Built to Sell: Creating a Business That Can Thrive Without You,* the book was designed to illustrate how to transform a successful business into a sellable one. In it, I touched briefly on the importance of having customers who repurchase from you on a regular schedule, but in hindsight, I should have dedicated at least half the book to recurring revenue.

In the years since *Built to Sell* was published, I've come to see how important recurring revenue is in building a valuable, sellable company. These days I run a subscription business called The Sellability Score (SellabilityScore.com) that helps owners build valuable companies by examining the eight key drivers of sellability. Owners who achieve a Sellability Score of 80 or more out of a possible 100 garner offers that are 71% higher than the average.

The biggest factor in driving up your Sellability Score is the degree to which your company can run without you, the owner. That's a head scratcher for a lot of owners who are the best salesperson in their business. The secret is to build recurring revenue that brings in sales without having to resell the customer each month.

To appreciate the impact of recurring revenue on your company's value, you have to understand what buyers are buying when they acquire a business. Most owners want buyers to value their past achievements, such as last year's profits or an industry award they're proud of. In fact, it has been my experience that financial buyers are really buying only one thing when they purchase a company: a *future* stream of profits.

In the home security business, for example, companies have two forms of revenue. They receive *installation revenue* when they come to your home or office to install the keypad and wire things up, and they receive *monitoring revenue* in the form of the monthly payment for keeping an eye on things.

At SellabilityScore.com, we know from our analysis that when an acquirer buys a security business, it pays 75 cents for "one off" installation revenue and *$2* for every dollar of monitoring revenue. Said another way, a security company with one hundred percent monitoring revenue (the subscription aspect of such a business) is almost three times more valuable than a security business of the same size that has one hundred percent installation revenue.

The same trend plays out across most industries. Accounting firms are valued based on their recurring fees. Financial planning practices trade based on how likely clients are to stay with the firm after the owner retires. IBM's stock moves up and down based on its recurring revenue from service contracts.

So recurring revenue makes your business a lot more valuable, and it also makes your company less stressful to run.

The Tyranny of Selling & Doing

In 1997, I started Warrillow & Co., a research company. We started out as a typical "sell/do" services business; our job was to cultivate relationships with people, listen to their problems, and try to come up with a solution. Each project was different, and we spent the majority of our time developing custom proposals, many of which were never accepted.

The company was profitable on paper but debilitatingly stressful to run. I hated the first day of each month because that was when all the dials turned back to zero and we had to scramble to find enough business to cover our overhead.

I remember distinctly the first time our fixed expenses crested $100,000 per month. I thought to myself, "If we don't sell anything this month, we still have $100,000 in expenses to cover!"

The stress of having to re-create the business from scratch each month led me in search of a better model. I started to study other research companies, like Gartner and Forrester Research, that had successfully "productized" a service and, as a result, began experimenting with automating parts of our business.

Instead of doing "one-off" research, we decided to offer the identical packages of information to a subscriber base of customers. Instead of doing custom proposals, we created a brochure about our offering and a standard proposal. Instead of getting paid 60 days after the project was complete, we charged up front for an annual subscription to our research.

The business became much less stressful to run. We went into each new month with revenue on the books, and we were no longer beholden to any one customer. In fact, we starting winning the world's largest companies as subscribers, including American Express, Apple, AT&T, Bank of America, Dell, FedEx, Google, HP, IBM, MasterCard, Microsoft, Sprint, Visa, and Wells Fargo. Charging for our subscription up front also meant that after a while, we had more cash than we knew what to do with. To top it off, we were growing at a rate of 25% a year and were quickly replacing the revenue from the one-off projects we had left behind. Warrillow & Co. was acquired by a public company in 2008.

You may be thinking, *That's nice, but it would never work in* my *industry or in* my *company.* Maybe—especially if you cling to the standard industry practices of your category. But as you'll see, virtually every business—from a start-up to a Fortune 500 company, from a home contractor to a manufacturer—can create at least some recurring revenue if it is willing to jettison the old way of doing things to pioneer a new business model.

And companies that don't just might face competition from those that do. Increasingly, some of the smallest businesses in the world are facing crippling competition from the largest. The subscription economy has pitted small companies against big ones and suppliers against resellers, and has even made partners into enemies. The battle lines are being drawn, and I hope *The Automatic Customer* will be your secret weapon for winning in the subscription economy.

If you are someone who has a business that you would like to make a little more predictable, a little less stressful, and a whole lot more valuable, this book is for you. Whether you want to transform your entire business model or just pick up an extra 5% of automatic revenue, I hope you'll see yourself in the following pages.

What You'll Find Inside

The book is organized into three sections. Part One outlines the surprising truth about who is winning in the subscription economy, why companies like Apple and Amazon are transforming themselves into subscription businesses, and why virtually every venture-backed start-up has a recurring revenue model.

We'll also look at eight ways your business will be more valuable and less stressful after you adopt the subscription model. You'll learn how the subscription business model dramatically increases the average value of each of your customers, and how to smooth out demand in your company so that it matches your ability to fulfill it. We'll discuss why automatic customers buy more than one-off customers and why subscription revenue is stickier than a one-time purchase.

Part Two is divided into mini-chapters on the nine subscription business models. As you'll see, you have a variety of choices when it comes to building a recurring revenue stream for your business. Whether you want to transform your entire business or just pick up a few thousand dollars of passive income, you'll get a ton of new ideas for applying the subscription model to your company.

The third and final section of *The Automatic Customer* gives you the blueprint for building your subscription business. We'll discuss a handful of key statistics that will define the viability of your subscription and highlight one ratio you must achieve in order to scale up. We'll look at the psychology of selling your subscription and how to overcome something I call "subscription fatigue." Then we'll turn to financing the growth of your subscription business and explore whether you want to raise venture-capital funding, as WhatsApp and Dollar Shave Club did, or self-fund your growth, like FreshBooks and Mosquito Squad. Part Three ends with a discussion on scaling your subscription business.

Let's get started.