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MRR – Monthly Recurring Revenue

Simply put, Monthly Recurring Revenues (MRR) are revenues that a company can count on every single month - in other words, a predictable income. It is a single number that can be used to track all recurring revenue over time in monthly increments. Often this is a by-product of a subscription business - a service that is billed (and paid) monthly.
Monthly recurring revenue as a KPI is arguably the most important metric for subscription businesses - and something investors love to see. MRR forms the basis for the following financial approaches:

- Calculating CLV (customer lifetime value).
- Projection of future revenues
- Evaluation of ASP trends (average selling price)

To calculate your monthly recurring revenue, simply multiply your total number of paying users by the average revenue per user (ARPA). This will give you a meaningful KPI that will help you plan and predict revenue goals.

Monthly Recurring Revenue = Number of active customers x Monthly revenue (or subscription price)

Example:
So, assuming you have 1,000 customers and only offer one rate, say 25 euros monthly, you have an MRR of 25,000 euros.

Expansion MRR

MRR describes recurring revenue per month. The Expansion MRR Rate is a more advanced metric that reflects new revenue from existing customers per month. Revenue collected from new customers (new MRR) is excluded here.

Expansion MRR occurs when subscribers

- switch from a free to a paid subscription (Free -> Premium)
- switch from a cheaper to a more expensive plan
- subscribe to paid monthly add-ons
- reactivate a cancelled subscription
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Calculation of the Expansion MRR Rate

Typically, the Expansion MRR rate is calculated as a percentage, comparing the current month to the previous month - so you can see if your existing customers are buying more or less of your products and services.

[(Expansion MRR at the end of the month - Expansion MRR at the beginning of the month) / Expansion MRR at the beginning of the month] x 100 = Expansion MRR percentage

Example:
Suppose the Expansion MRR rate for early January is EUR 1,500 and the Expansion MRR rate for late January is EUR 2,000.

[(EUR 2,000 - EUR 1,500)/EUR 1,500] x 100 = 33.3% Expansion MRR Rate

ARPA – Average Return per Account

What is ARPA and what types are there?

Average revenue per account (sometimes known as average revenue per user or per unit), usually abbreviated ARPA, is a measure of revenue generated per account, usually per year or month. It can be said to represent average revenue per customer - keeping in mind that a customer may have more than one account, depending on the characteristics of their product or service. ARPA allows for analysis of a company's revenue generation and growth, which can help them identify which products are generating higher or lower revenues. It is also a way for the company to identify which products are performing better in the market.

Basically, there are two different types of "Average Revenue per Account": new and existing ARPAs. This is especially relevant when pricing needs to change significantly and a more accurate average revenue per new account is desired. It is also useful to understand how ARPA evolves based on the behavior of existing accounts compared to new accounts.

How to calculate ARPA?

To calculate ARPA, a standard time period must be established. Most subscription businesses operate on a monthly basis, but they can also be calculated annually or quarterly according to billing schedules and options. The total revenue of all customers (paying subscribers) during this period should be divided by the total number of customers.

Thus, the calculation is as follows:

ARPA = recurring revenue over the agreed period/total number of customers

If ARPA is measured on a monthly basis, your recurring revenue is thus Monthly Recurring Revenue, or MRR.

The existing ARPA is calculated using the same formula but based on segmentation of average revenue and number of accounts for the desired time period (say, last year).

The new ARPA is also calculated using the same formula as shown above, but the recurring revenue and number of accounts are limited to any time period specified as "new".

If a freemium model is offered, the free accounts are usually not included in the calculation.

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Renewal Rate

Definition: What is Renewal Rate?

There are a few possible interpretations of Renewal Rate. Often the term is interpreted as Recurring Revenue, Customer Renewals or as Retention Rate. However, the Renewal Rate is easily explained for subscription models. Unlike the retention rate, for example, the renewal rate does not generally measure existing customers in comparison to new customers. More specifically, the renewal rate is the percentage of customers who renew their contract after the subscription expires. In consequence, this means: The higher the renewal rate, the more likely the company is to achieve its long-term revenue goals.

For which offers is the renewal rate particularly suitable?
As mentioned earlier, it is a very important metric that should be relevant for all subscription models. Determining the optimal value for the Customer Renewal Rate is therefore highly dependent on the service offered and the market in which it operates. This metric is very sensitive to factors such as economic stability and the emergence of new competitors. Ideally, the renewal rate is above 80% - which is the value usually achieved by SaaS companies.

No matter where the value lies, this metric should always be part of a company's financial consideration. After all, it provides stability and predictability to Monthly Recurring Revenue (MRR). Knowing what the customer renewal rate is every week or every two weeks can help you come up with strategies that will yield results in the same month.

Calculating the Renewal Rate

There are two ways to calculate it, one based on contract renewals and one based on monetary value. To calculate the rate based on contracts, the equation should look like this:

Formula for calculating the renewal rate by contracts

Renewal rate by contracts = Number of renewed contracts / total number of renewable contracts

If the customer renewal rate is to be calculated on a basis in terms of cash flow, the following equation applies:

Renewal Rate by Cash Value = total value of renewed contracts / total value of renewable contracts

Tips for increasing customer retention in the subscription business

To significantly increase the renewal rate, some strategies can be taken. The following measures should be considered:

- Target group-specific offer creation: read the customer's wish from their lips and plan actions that are targeted to each usage profile. To do this, simply strategically use the data the company has from the user's registrations and activity.
- Identify cancellations and unsubscribes: Low-interacting users tend to cancel more easily because they perceive the value of the service to be low. To encourage engagement, the company needs to be in frequent contact with users, use various forms of notification, and/or conduct frequent satisfaction surveys. This way, churn can be kept lower.

- Offer discounts: Plan to offer targeted discounts, such as for an annual subscription. Also, the company must provide offers for a defined period of time, starting before the end of the contract.
- Discover brand or service ambassadors: Knowing who your most engaged and satisfied subscribers are, also called promoters, can help you understand what makes your subscription model stand out. Then, when you interact with a quitting customer, or detractor, you can finally draw attention to the benefits perceived by satisfied customers. You could also use promoters as brand ambassadors, as some of them may have even built up a social media reach to match.

Conclusion: renewal rate is an important metric for predicting future growth
Customer renewal rate is easy to calculate: Simply divide the number of customers/contracts renewing at the end of the specified period by the total number of customers/contracts that were scheduled for renewal, and then multiply that number by 100. In a successful subscription business, the rate needs to be high enough that the entire business is on a growth path, either in total number of customers or measured by revenue. It is a metric that can measure the long-term relationship between the business and its customers and ensure the success of a subscription model.

CAC – Customer Acquisition Cost

Customer Acquisition Cost -Definition of CAC

The Customer Acquisition Cost is the sum of all costs for sales and marketing activities that are spent to acquire new customers. CAC is an indicator of how much a company invests and how efficiently it uses this investment to acquire customers. Customer Acquisition Cost is one of the factors that determine whether a SaaS company has a viable business model.

The basics of the CAC calculation

For a better understanding, CAC is the sum of investments in marketing and sales divided by the number of customers acquired during the same period. It is an essential metric for measuring the financial health of a company. Customer acquisition costs are calculated monthly, taking into account sporadic fluctuations. The first step in calculating it is to neglect all areas of the business that are not directly related to customer acquisition. Some examples are: Product Department, Support, Administration, etc. On the other hand, only the marketing and sales departments are taken into account, as well as the number of new customers in the desired period.

Investments to consider in marketing: Salaries, tools, media (e.g., ads), events, and anything else used to showcase a product and ultimately generate leads for the sales team.
Investments you should consider in sales: Salaries, commissions, tools, telephony, travel, and all the infrastructure used by sales to acquire new customers.
New customers: Finally, we need the number of new customers acquired during the same period.

The calculation of the CAC

Once we have all the values of the above, we simply apply the following formula:

CAC = (investment in marketing + investment in sales) / number of new customers

This metric not only indicates whether your business is economically sound but can also greatly help marketers make strategic decisions and optimize investments. For the subscription business, the Customer Acquisition Cost must be lower than the CLV (Customer Lifetime Value), which is roughly the average amount each customer will spend with the company over the course of their lifetime.

Measures to reduce the Customer Acquisition Cost

Companies want to grow and reduce costs. One important metric is the customer acquisition cost. However, this requires adjustments and optimization in the company's operational practices. Here are a few tips for reducing Customer Acquisition Cost:

- Invest in good content: Those that invest in quality content that provides answers and/or solutions to the needs of potential customers become the reference in the field in which they operate. Building credibility is essential for the potential customer to ultimately trust a brand and ultimately purchase a product or service.
- Correct targeting: To optimize the Customer Acquisition Cost, it is necessary to know exactly the target group of the service offered. In this way, it is possible to understand the behavior of the buyer during the customer journey and have relevant content ready for each stage of the sales funnel. This enables companies to channel their investments in marketing and sales activities and direct them to the right channel with the appropriate segmentation.
- Loyalty to customers (CRM) so that they remain loyal to the company and can become promoters to other new customers in the future.
- Monitoring: companies should plan well and set benchmarks before implementing the reduction measures. All indicators should be tested and monitored to avoid excessive spending.

Conclusion: Using CAC metrics can improve a company's results
CAC is a very important key performance indicator (KPI), especially in the subscription business, that can tell a lot about companies' ability to turn investments into real profit. Reducing CAC by optimizing or diversifying channels is one of the biggest challenges to overcome. With proper marketing, knowledge of the target audience, and planned and targeted investments, it is possible to reduce Customer Acquisition Costs and thus improve a company's profits.

CLV – Customer Livetime Value

Customer lifetime value (CLV) is an important business metric, especially in the subscription economy. It is based on the contribution margin that a customer realizes during his customer lifetime.

The calculation of CLV is based on the principle that it is always cheaper to maintain and retain existing customers than to acquire new ones. In other words, the CLV is fed by assumptions in the areas of life expectancy, revenue expectancy, cost expectancy, and risk expectancy. In this context, the revenues generated by a company through its products and services must exceed the expenses for the production and sale of these products, at least in a larger time frame. While this can still be determined very well for goods, it looks somewhat different for marketing measures. What does the company earn through advertising? Do the revenues exceed the expenses for conception and production?

The CLV is therefore used to determine the profitability of a product or company in an interdisciplinary manner and over a longer period.

CLV and Subscription Economy

Subscription business models are powerful in terms of customer lifetime value because they create an environment where the default customer behavior is retention. The situation is quite different for non-subscription business models, where the default behavior is churn, even when CRM measures are considered.

However, the underlying concepts that drive subscription business can be complex at the start of a startup. The mainstay of any subscription business is therefore CLV, the total profit that can be expected from a new customer over the course of his or her lifetime. The CLV thus drives the willingness to pay when acquiring customers. How much should I spend on my customer in total? In product development, marketing, sales & co.?

Determining customer value: How can I calculate the CLV?

Customer lifetime value can be calculated in various ways. The complexity of the calculation depends on the content. What exactly do I want to calculate, and which departments do I want to take into account when determining the customer value? Basically, three important key figures must first be determined before the CLV can be calculated:

- What is the average order value?
- Where is the repurchase rate and where is the customer retention rate?
- What are the customer acquisition and retention costs?

The repurchase and customer retention rates are based either on an assumption or, in the best case, on empirical values. So, for example, if 75 out of 100 customers from last year are still their customers this year, the customer retention rate is 75 percent.

Note: The advantage of subscription models is that customers are already repeat buyers by definition, often over twelve months. Therefore, an annual calculation of the repurchase rate in this case makes sense in terms of a realistic view.

Here is an example calculation based on the following assumptions:

Customer acquisition costs: 60 euros
Customer retention rate: 75 percent
Repurchase rate: 12 purchases per year
Contribution margin: 30 euros

First, the customer lifetime is calculated:
1 / (1 - 0.75) = 4 years

On the basis follows the calculation of the customer value based on his customer lifetime:
(30 euros x 12 purchases) x 4 years - 60 euros acquisition costs = 1,380 euros.
Thus, the customer lifetime value is 1,380 euros.

However, a look at the company's own rate model shows how complex the determination of the customer value is. If, for example, there are upgrades to premium versions, higher rates, or in-app sales, another dimension must be considered in the CLV calculation.

Conclusion: Customer Lifetime Value as a supporting forecasting tool
Customer lifetime value is a per se meaningful metric for determining how much should be spent on acquisition and marketing for a customer. At the same time, the method also harbors predictive uncertainty. Start-ups find it difficult to estimate the likely duration of the customer relationship, and even more so the potential spend and revenue. Companies with a history of several years have it easier here. And yet, especially in the subscription economy, the CLV should be seen as a supportive and dynamic forecasting tool that gets better and more accurate from month to month and year to year.

Churn

Churn and churn rate - what is it?

Churn means customer attrition and occurs when subscribers stop their relationship with a company, product, or service. Customer churn can cause a company's growth to suffer (temporarily), which is why it is essential for companies to have a sufficiently defined method for calculating churn over a given period.

Churn rate is specifically the percentage of customers who stop purchasing products or services from a particular company, calculated for a specific period. This helps companies measure the number of customer churn. Churn rate is one of the most important metrics in marketing, customer management and customer relationship management.

Customer Acquisition Cost vs. Churn Rate

The cost of customer acquisition (CAC) is generally higher than the cost of maintaining existing customers, making the churn rate an extremely important metric for measuring the success of a subscription business. Ineffective churn prevention can create unwieldy additional costs in the marketing budget. Thus, companies can subsequently develop customer retention strategies, new incentives, discounts, promotions and other measures to retain customers, improve customer lifetime value (CLV) and reduce their churn rate.

How is the customer churn rate calculated?

To calculate the rate, the number of active customers within a month must be divided by the number of cancelled customers in the same month, as the following chart illustrates.

Churn rate = (QC / QA) * 100

*QA stands for the number of active customers, QC for the number of cancelled customers.

Measuring customer churn is an important KPI for the success of a company and should be analyzed to the same extent as the number of new customers, MRR (Monthly Recurring Revenue) and other relevant company figures.