1 The Recurring Revenue Tsunami: Why Customer Success Is Suddenly Crucial

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In the Beginning

In the spring of 2005, Marc Benioff gathered his lieutenants together for an offsite in the sleepy seaside town of Half Moon Bay, California. San Francisco–based Salesforce.com was on a roll, the likes of which has been seldom seen, even in the technology world. After a swift five-year run to a successful initial public offering (IPO) in June, the remainder of 2004 brought more good news in the form of 88 percent bookings growth. Nearly 20,000 customers had purchased the company's customer relationship management (CRM) solution, up from less than 6,000 two years prior. The year 2004 concluded with Salesforce sporting a market cap of $500 million, and that number would quadruple by the end of 2005. All charts were pointing up and to the right, just the way you'd want them if you were an employee or an investor.

The offsite was pretty typical, celebrating the success of the company, planning for continued hypergrowth as the market continued to expand, and generally mapping out a glorious future. And then David Dempsey stepped to the podium to deliver the presentation that would earn him the nickname Dr. Doom.

By 2005, the Irish-born Dempsey was already five years into his Salesforce career. He had spent 11 years at Oracle before moving on, just as the dotcom bubble burst. Unfazed, he and two other ex-Oracle executives approached Benioff in early 2000 with a proposal to bring Salesforce.com to the European market. After several months of negotiations, the deal was struck. Today, Dempsey is a senior vice president and the global head of renewals, which, as is the goal of all recurring revenue businesses, carries 70 to 80 percent of Salesforce's annual bookings responsibility. In 2015, that renewal number is approaching $5 billion.

When you have that kind of responsibility, you quickly begin to understand the levers of the business and what it takes to be successful. Great sales leaders and CEOs have made their careers by understanding what's happening in the market and in their businesses and by taking the necessary steps, within their control, to keep their business growing. That might require major product changes, breaking into new markets, or any number of other strategies. The same general blueprint has been followed for years. But for Dempsey, there was something distinctly different about this challenge. No one had ever done what he was trying to do. No other subscription-based business-to-business (B2B) company had ever reached the size and growth rate of Salesforce, which also meant that, before him, no one had really needed to understand the reality and nuance of subscription software renewals the way he had to.

Renewing software subscriptions is not like renewing maintenance contracts in which the hardware or software is already paid for, installed in the data center, and running critical parts of the business. And, by the way, leaving the customer a prisoner to the vendor in many ways. One of the imprisoning factors is the cost of hardware maintenance. If the hardware is critical to the company's infrastructure, then you are basically required to pay for insurance in the case of failures. Paying for maintenance is that insurance. To make things worse, the hardware vendor typically has a stranglehold on the maintenance market because they are often upgrading and replacing proprietary hardware components. Sure, over time, a few third-party options have sprung up, but vendors always keep at least 90 percent of the business, so the competition is token at best. The software maintenance business is an even better business for vendors because no one else can provide software upgrades and bug fixes for their proprietary software. So, the renewal of a maintenance contract—hardware

or software—is mostly a formality, with a tiny bit of negotiation involved. Unfortunately, the assumptions about maintenance renewals carried over to the SaaS (Software as a Service) world that Dempsey and Salesforce lived in. Those assumptions were misleading at best.

The renewals Dempsey was responsible for were often battles, not givens. For most SaaS products, customers have choices. Even with 20,000 customers, Salesforce was still often as much nice-to-have as it was must-have, which is always the case in a new market, as CRM was at the time. The bottom line on SaaS renewals is that customers can, and do, choose to not renew their contracts at a much higher rate than for maintenance products. That's because they usually have choices. Other vendors in the same market offer easy conversions to their product and lower prices. Customers are not captive like they are to maintenance contracts. That's just one of many ways that the recurring revenue business model has shifted power from the vendor to the customer, and Salesforce in 2005 was no exception. Customers had choices—competitors, the option to build their own solution, or just to do without CRM altogether—and they exercised that choice. Boy, did they ever.

Into the middle of that reality strode Dempsey, understanding it in a way that no one else did because he was the man responsible for renewing Salesforce customers' contracts. The message he shared with the rest of the Salesforce executive team was not good news. The bottom line was simple and direct: despite what it looked like from the outside, Salesforce as a business was in a death spiral. Underneath the glowing results and amazing growth rates, there was a fundamental flaw in the business, and continuing on the current path would bring disaster. The culprit was summed up in one simple word—*churn*. Customers who decided they no longer wanted to be customers. Churn. A luxury afforded to customers in a recurring revenue business. Churn. A simple concept, totally part of our thinking today, but one that, in 2005, no other subscription-based B2B company had dealt with at this magnitude. Churn.

The churn rate at Salesforce was 8 percent. That doesn't sound so bad until you add these two words—*per month*! Do the math if you wish, but it will come out like this: almost every customer was exiting the business every year. Salesforce was starting to learn what every other subscription company has learned since (thank you, Salesforce). You can't pour enough business into the top of the funnel to sustain real growth if customers are leaking out

the bottom at a high rate. Yes, you can show glowing growth rates for new customer acquisition, and that's a very good thing. But the allure and value of a recurring revenue business such as Salesforce is in *growing the overall value of the installed base*. That takes new customer acquisition plus high retention rates plus positive upsell results (selling more to existing customers). Only when all three of those gears are working do you have the healthy business engine that investors will reward.

Dempsey's presentation awakened Benioff and set the wheels in motion around a company-wide initiative to focus on, measure, and reduce churn. One simple, fact-based presentation delivered to the right audience at the right time started something that is only now, 10 years later, gaining full traction as a discipline and a business imperative for all recurring revenue businesses. Dr. Doom had effectively given birth to the customer success movement.

Attitudinal versus Behavioral Loyalty

Customer success is ultimately about loyalty. Every company wants loyal customers. Recurring revenue businesses, such as Salesforce, *need* loyal customers. Acquiring customers is expensive. Really expensive. That makes keeping them a necessity, no matter how big your market might be. It's simply a losing battle to try to out-acquire a high churn rate. So, if a business depends on loyalty, it's critical to understand what that word means.

Much has been written about different kinds of loyalty. The general consensus is that there are two kinds of loyalty—attitudinal loyalty and behavioral loyalty. These are sometimes referred to as emotional loyalty and intellectual loyalty. The premise is simple although the social science may be quite complex. The premise is that there are customers who are loyal because they have to be (behavioral/intellectual), and then there are customers who are loyal because they love a particular brand or product (attitudinal/emotional). As a vendor or brand, the latter is highly preferable for a variety of reasons: willingness to pay a higher price, less vulnerable to competition, more likely to advocate for "their" brand, and so forth. The housewife who shops at Hank's Grocery because it's the only place within 30 miles that sells bread and milk is behaviorally loyal. It's possible she's also attitudinally loyal (Hank could be her husband), too, but

her basic loyalty is because she does not have options. That's the extreme example, but we're probably all behaviorally loyal to a variety of products. I get gas at the same place 90 percent of the time because it's convenient and, based on very little research, a good price. The fact that they shut down their credit card machines for 10 minutes at 7:00 every morning is annoying because that's exactly when I'm on my way to work. They don't know it, except for the cashier I expressed my frustration to one day, but this creates the opposite of attitudinal loyalty for me. Fortunately for them, the convenience continues to win the day for now. But they are vulnerable to another station popping up nearby, priced similarly, and with credit card shutdowns at 3 A.M. instead of 7 A.M. or, better yet, who has figured out that it's important not to shut down the credit card machines at all.

Attitudinal loyalty is much harder to create and sustain because it's expensive. It's expensive to build products that customers love instead of products that they simply own. It's expensive to create an experience that delights instead of one that just tries to not annoy. When my daughter was graduating from high school, she needed a laptop computer. What was it that caused her to stomp her foot and insist on a Mac when the Dell options were functionally comparable and much less expensive? The logical conversation I attempted with her did not move her an inch. Despite the fact that she couldn't cite a single speed, function, or quality argument for the Mac, her heart was set and her mind made up. I still don't know why (but she did get her Mac). Maybe it was because the cool kids all had one. Maybe it was because she loved her iPod. Maybe it was because she just liked jeans and black turtlenecks. I honestly don't know. But now I know what to call it—attitudinal loyalty or, in her case, more appropriately, emotional loyalty (because the discussion did include tears). And that's the kind of loyalty we all long for in our customers.

Apple has been chronicled in so many ways—papers, books, movies—that I will do it no justice here in comparison. It did something with regard to loyalty that looks and feels like magic but clearly isn't. There's just a certain quality to Apple's product, packaging, advertising, and presentation, and it creates not only a purchase but also an experience that somehow touches an emotional chord. Steve Jobs figured out how to create attitudinal loyalty perhaps better than anyone, before or since. And it's literally priceless. The fanaticism of Apple's loyal customers carried it through a very dark time when products weren't very good and its business teetered on the edge.

Apple came out on the other side with virtually all of its loyal fans (some weren't even customers) intact, and, then, when it started to make products that partially justified that fanaticism, the ride to the top (most valuable company in history) was full-speed ahead.

So, what's the point, and how does it relate to customer success? Customer Success is designed to create attitudinal loyalty. Marc Benioff and Salesforce figured it out and, over the past 10 years, have invested massive amounts of time and money into customer success. Behavioral loyalty wasn't really an option in the early years because Salesforce was never going to be the only game in town, and customers weren't sticky because they hadn't invested emotionally or financially into the integrations and processes that make switching really expensive. One could argue that lots of Salesforce customers today are behaviorally loyal because the product has become central to the way they do business and too difficult to swap out. But many of those customers are also attitudinally loyal—check out Dreamforce (their annual conference) sometime if you don't believe it—and that's the best of both worlds.

Steve Jobs also knew that attitudinal loyalty was critical, and, in addition to creating it with elegant and beautiful products, he also invested in customer success. But, being the marketing guru that he was, he came up with a different name for it—Genius Bar. When Apple decided to create retail stores, the naysayers were loud and numerous. Hadn't history proved that retail stores for computers didn't work (RIP Gateway)? What Jobs banked on correctly was that retail stores for a consumer technology brand, at least one with a core fanatical following, could work. And, of course, it did. One could argue that the publicity derived from the long lines outside Apple stores three days before the release of the new iPhone was worth the investment in all the stores combined. But Jobs took it one step further. He didn't settle for having stores only showing off and selling his products, no matter how many helpful salespeople there were in every store. He also created a place in the back of the store staffed with customer success managers. We'll explore in detail what we mean by *customer success manager* later in this book, but the simple role definition is this: individuals that help customers get the most value out of your products. That's clearly what Apple Store geniuses are intended to do. It wasn't cheap for Apple to decide to have 10 or 20 geniuses on the payroll at every single store. As we said, attitudinal loyalty is not cheap. But

it changed the nature of the relationship between vendor and customer by personalizing it and extending it beyond the purchase. That's something that very few business-to-consumer (B2C) or retail companies have figured out how to do. Maybe Zappos and Nordstrom have with their emphasis on customer service. Maybe Amazon has in a different way by adding Prime to its offerings. But I bet you can't think of a lot more. Interestingly, we all know that some of the geniuses at the Apple Store are not really geniuses at all. Many of us have even had frustrating experiences with them. The fact that they exist to touch and help real customers and build even the slightest relationship drives attitudinal loyalty. That's the art of customer success. Most vendors don't start with the fanaticism and loyalty that Apple does (a two-edged sword by the way), but we desperately want our customers to become advocates, not just customers. We need attitudinal loyalty not just behavioral loyalty. Customer success is the means to that end.

Marc Benioff created customer success out of his need to reduce churn. Steve Jobs created customer success out of his intuition that it would increase attitudinal loyalty to Apple products. We're lucky today that we can follow in the footsteps of two icons who have proved that customer success works regardless of your business model. It may seem more obvious, and more imperative, in a recurring revenue business, but it can be no less valuable in a traditional consumer business.

Tien Tzuo was the eleventh employee at Salesforce and, not coincidentally, in the room in Half Moon Bay for Dr. Doom's presentation. He is currently the CEO at Zuora, where he coined the phrase *the subscription economy* to describe the changing landscape as traditional businesses were getting disrupted by the move to a recurring revenue model. He also said, although he may not have been the first, "In traditional businesses, the customer relationship ends with the purchase. But in a subscription business, the customer relationship begins with the purchase." That's a powerful distinction and Benioff and Jobs both realized it and invested heavily in it. Benioff created the most successful subscription-based software company in history. And Jobs brought the subscription thinking and attitude into a nonsubscription business in a way not previously done. Many other traditional companies will choose the same path in the coming years, while recurring revenue businesses will not have the luxury of choice.

The Subscription Tsunami

Customer success sounds like a catchy phrase your marketing team might come up with, doesn't it? Or a mantra some PR firm concocted for their CEO to make it sound like she really does care about customers. But in today's recurring revenue businesses, customer success is much more than a catchy phrase or a slick marketing campaign. It's a necessary part of any subscription business, as Mr. Benioff and Salesforce proved, and it requires investment, attention, and leadership. It's not lip service around "putting customers first" or "the customer is king." Those phrases sound good but such campaigns often start off with a bang and then fizzle quickly unless they are driven by a passionate and charismatic leader (like Tony Hsieh) or by a business imperative. Customer success, as we'll discuss throughout this book, falls squarely into the latter category. It does not require a passionate or charismatic leader, although that helps, because it's nothing less than life or death in the subscription economy.

Real organizational change in business is rare. Think about our organizations today—sales, marketing, product development, finance, and services. Those have been the fundamental components of an enterprise for hundreds of years despite the enormity of change within the business world during that time. One could argue that human resources is new, but the reality is that it was always being done, just not led by a separate organization. As far as fundamental organizations go, information technology (IT) might be the only truly new invention in the past 70 years, driven obviously by the ubiquity of technology in every aspect of our jobs. Customer success is the next big organization change. As with IT, customer success is becoming a thing because something else is changing—in this case, the business model. Subscriptions are all the rage. From software to music to movies to diet programs. The way to the heart of investors and the public markets is to establish a business that creates monthly recurring payments from lots and lots of customers. If Wall Street and the investment community love something, so do the CEOs. If a business is not subscriptionable, it is probably becoming pay-as-you-go, which has all the same characteristics and imperatives. Subscriptions are obviously not new, but the movement of existing businesses from a nonsubscription business model to a subscription model most certainly is. Everyone is searching for a recurring revenue component to their business model and, ideally, the

whole business, not just a component. This 15-year-old movement started with the software world, but the splash caused by that boulder is rippling across virtually every other industry, too.

Thus, the need for this book. The subscription tsunami is well under way and having a massive impact on the software world. Customer success is one of the secondary waves being drawn in behind the tsunami. But customer success is not only a new organization but also a philosophy sweeping its way into nonsoftware, nontechnology, and non-B2B companies. It may not have been referred to as *customer success* until recently, but it's happening everywhere, as witnessed by the Apple story, driven by technology and the availability of information (i.e., the Internet). No matter what kind of business you are in, now is the time to understand what to do about this wave. Let's start by exploring the origins of customer success in B2B software because that's where this all began.

Software is eating the world. That statement was only slightly controversial when Marc Andreesen first wrote his famous essay in 2011.

"Why Software Is Eating The World"—http://www.wsj.com/articles/SB10001424053111903480904576512250915629460

Today, his notion has moved from bold and futuristic to indisputable. If there's any truth to it at all, it's critical that every business leader understands what is happening in Silicon Valley. The software industry has gone through a dramatic transition over the past 15 years, and the customer is at the center of this transition. This change has been driven by the ubiquity of the Internet and the advent of that thing called *the cloud*. In fact, the farther away we are from the beginning of this transition, the clearer the bifurcation between the way things were done BC (before cloud) and AC (after cloud). The change has altered almost every aspect of the way a software company works but is best understood through the lens of the customer. In particular, B2B software customers AC differ from BC customers in two very important ways:

1. How they purchase software
2. How their lifetime value (LTV) is realized

These two themes are closely related. In fact, number 1 is the reason for number 2. To be truly precise, the major difference in the purchasing process is not really *how* customers purchase a software product but *that* they

purchase a software product. In the days BC, unlike today, the purchase transaction actually did result in a change of ownership. This model, commonly referred to as a *perpetual license*, passed ownership rights to use the software from the vendor to the customer at the time of the transaction. Because of the singular nature of this transaction, the vendor needed to maximize the monetary value of it in order for its business model to work. The result was that the cost of the initial software purchase was relatively very high, not to mention the associated hardware costs. For a software company, especially enterprise B2B, this was the only path to profitability (yes, there was a time when that mattered).

A consumer scenario, which might bring back memories for some of you, helps to illustrate how dramatic this change has been. When I was 16 years old, I fell in love with a song I heard on the radio, "Bohemian Rhapsody" by Queen. It was amazing and complex and needed to be listened to over and over (although my mother might disagree with that last point). The only way to accomplish that goal in those days was to purchase the album ("A Night at the Opera," for those who care). So that's what I did. I went to my nearest music store and plunked down $16.99 for the 8-track (if you don't know, look it up), a lot of money for a 16-year-old kid at that time. Basically, I paid $17 for one song. To play and listen to that song, I also had to have a pretty expensive stereo system. You know, the ones with the three-foot-tall speakers that doubled as bar stools. And that's the way it was—$1,000 stereo system and $17 for the album to listen to one song. This was basically the consumer music ownership experience for the better part of 50 years. The first major change, other than format and not counting Napster, in how we consumed music came thanks to Apple—the ability to purchase just one song for 99 cents on iTunes. This was revolutionary (it literally started a revolution) for the music industry. In fact, it fundamentally changed it forever, but the analogy to the software world was only completed when streaming music services, such as Pandora and Spotify, came along. No longer are songs even purchased. They are leased, and, depending on how much music you listen to, the cost per song may be down to pennies or even less. I could have listened to "Bohemian Rhapsody" thousands of times through my computer (purchased primarily for other reasons) for only a few bucks. Thankfully, for all us parents, this change was accompanied by the invention of earbuds and small and inexpensive personal music players (PMP). What drove this change in how

we purchase (or lease) music? Technology and the Internet. The very same drivers that changed the way companies purchase their CRM system. (See Table 1.1.)

Music

Table 1.1 Consuming Music Before and After the Cloud

	Before Cloud	**After Cloud**
Ownership	Album	None—lease/subscription
Price	$1/song	$.01/song
Quantity	15 songs	Millions of songs
Hardware	Stereo	PMP/phone/computer
	Big speakers	Earbuds
Hardware price	$1,000+	$50 PMP, $0 for existing devices
Availability	Home/car	Anywhere

Software—Siebel versus Salesforce

In those days BC, it was common for a software deal, such as the Siebel one approximated in Table 1.2, to be a multimillion-dollar transaction. It was also common for that initial deal to constitute more than 50 percent of all the money the vendor would collect from that customer over its lifetime. In the earliest days, before software maintenance fees, that percentage might even exceed 80 or 90 percent. Contrast that with the Salesforce example (AC), and you'll begin to understand point 2—the realization of LTV from each customer over a much longer period.

It's not hard to grasp what happened and why. Let's say I'm the CEO of a software company, and I sell you my solution for $3 million. I'm well aware at that point that all of the additional money I will collect from you over your lifetime as my customer is maybe another $500,000. Given that reality, your value to me diminishes dramatically the moment your $3 million is in my bank account. That's not to say that I, or any past or current CEOs, don't care about customers. Of course we do. As we all know, customers have value beyond what they pay us—references, case studies, word-of-mouth,

Table 1.2 Consuming Software Before and After the Cloud

	Before Cloud	After Cloud
Ownership	Application	None—lease/subscription
Price	$2 million	$2,000–$20,000/month
Hardware	Servers	Included in subscription
	Networking	Included in subscription
	Storage	Included in subscription
Hardware price	$2 million	Included in subscription
Time to install	9–24 months	0–6 months
People	Lots	Few
Availability	Office	Anywhere

and so on. But that additional value, even if you include the future monetary value that comes from the purchase of more products, licenses, and maintenance fees, does not change the fundamental viability of my business. I can still survive, even thrive, based exclusively on my ability to continue to sell new customers for that same price. I may care passionately about my customer's success, but if it doesn't matter to the bottom line whether they get value or even use my solution, then I'm highly unlikely to invest significantly in ensuring their success. It was this reality that led to the birth of the term *shelfware*. That was just a cheeky way to describe software that wasn't being used by the customer. That still happens today by the way. SaaS did not solve the adoption problem by any means. It just matters a lot more now than it did back then.

Although lots of B2B software is still purchased the old way, the tide has forever shifted. Today, the vast majority of software companies are using this new model in which the software is never actually purchased but leased. With this new model, SaaS, customers do not own your software; they pay for the use of it on a subscription basis with a time-limited commitment. Many software companies lease their software on a month-to-month basis while others require an annual contract or longer. But, in all cases, there's an end date to the subscription, which requires a renewal. This, then, is the subscription economy. No more paying a large, onetime fee up-front; instead, software is leased on a short-term commitment. Another related

wave takes the subscription concept one step further into a pay-as-you-go model. Google AdWords and Amazon Web Services are examples of pay-as-you-go. In both models, customers have become significantly more important because their LTV really matters, not only what they pay in the initial transaction. Therein lies the need for a philosophy and an organization–customer success.

Simply put, customer success is the organization or philosophy designed to drive success for the customer. That sounds amazingly obvious, but, as we mentioned earlier, there was a time when the success of our customers was not really a business imperative. That's no longer true. You see, successful recurring revenue customers today do two very important things:

1. They remain your customers.
2. They buy more stuff from you.

It's a fundamental reality for CEOs today that, if their customers aren't taking both of those actions, their business has no chance of success. The economics just don't work. And that is why customer success has become an imperative. We'll circle back here after we take a brief look at the origins of the subscription economy, which really started with the development of SaaS. Understanding the history is important because all recurring revenue businesses are following in the footsteps of the earliest SaaS companies.

The Birth of Software as a Service

In the fall of 1995, John McCaskey walked into the Stanford Bookstore in Palo Alto, California, and bought several books, *Foundations of World Wide Web Programming with HTML & CGI*, *HTML & CGI Unleashed*, and O'Reilly's *Programming Perl* among them. At the time, McCaskey was a marketing director working for a company named Silicon Graphics (SGI). Despite his marketing title, McCaskey was an engineer at heart, and his new book collection had a purpose greater than simply a hobby. His intent was to reprogram an internal application, lightly used by the SGI marketing community, called MYOB (mine your own business). MYOB was a business intelligence (BI) tool, built on top of Business Objects. Its intent was

to provide insights to the marketers regarding the sales of their products. As McCaskey's version started to take shape, it became known as MYOB Lite.

That very same year, on the other side of town, Paul Graham, self-proclaimed hacker and future Silicon Valley icon, and his friends Robert Morris and Trevor Blackwell were starting a company called Viaweb. Viaweb was also the name of their application, originally known as Webgen, which allowed users to build and host their own online stores with little technical expertise.

Both MYOB Lite and Viaweb were wildly successful. MYOB Lite caught fire at SGI because of its ease of access and use and was quickly adopted and used by 500-plus marketers and executives. Viaweb, on the other hand, was a commercial success. By the end of 1996, more than 70 stores were online, and by the end of 1997, that number had grown to more than 500. In July 1998, Graham and company sold Viaweb for $50 million in Yahoo! stock, and it became known as Yahoo Stores. He went on to form Y Combinator, a wildly successful technology incubator, out of which has come many great companies including Dropbox and Airbnb.

In addition to their real-world success and the springboard they provided for their inventors, Viaweb and MYOB Lite had one other very important thing in common. The user interface (UI) consisted only of an off-the-shelf Web browser. Paul Graham referred to Viaweb as an *application service provider*, and John McCaskey's application was simply a light version of a Business Objects implementation, sans Business Objects. In other words, Viaweb and MYOB Lite were two of history's first SaaS applications. *SaaS* is today's term for applications that do not require any client-side software. The only product needed to run them on the user side is a web browser. Today, there are thousands of SaaS applications. We use them every day—Facebook, Dropbox, Amazon, eBay, Match.com, Salesforce.com, and virtually every other software application developed in the past five years. But, in 1995, the concept was revolutionary and initiated a seismic shift in the software industry.

SaaS truly changed everything. Buyers of software not only could now lease it instead of purchase it, but do so for a much smaller financial commitment (see Table 1.2). In addition, they no longer needed to purchase expensive hardware on which to run that software and costly data centers in which to put that hardware. Remember that expensive stereo system we

discussed earlier? That was the music equivalent of the BC software world's data center. They also didn't need to hire and pay for expensive employees to run those data centers and manage the new software. Applications still ran on servers, but those servers were now owned and maintained by the vendor, not the customer, and were accessed and operated through a web browser and a URL. Today, most of those data centers have been consolidated by a few companies who provide hosting and security and easy extension of the infrastructure as needed so the software vendors often don't even host their own software any longer. This critical task is usually outsourced to companies such as Amazon Web Services and Rackspace.

SaaS → Subscriptions → Customer Success

This shift to SaaS as the new way of delivering software led directly to the most important change of all—subscription-based licensing. It kind of made sense that if customers no longer had to purchase hardware to run applications, they shouldn't have to purchase the software either. In the past, the cost of hardware, data centers, security, and the people required to run everything were absorbed by the customer. But today, all of those elements of a solution are provided by the vendor, along with the software, and that has paved the way for subscriptions as the vendor's pricing model. Before the Cloud, software had also always been purchased and owned by the customer—the "perpetual license" we mentioned earlier. But the rise of the Internet and SaaS as a delivery model created the option, for many now the only option, to simply lease the software. We often refer to these subscriptions today as "software subscriptions" but in reality, the customer is really leasing not only the software, but also some portion of the entire infrastructure required to run it, typically on monthly or annual contracts.

These two changes happened almost simultaneously and are inextricably linked, but they are worth distinguishing here. SaaS is simply the delivery model that allows applications to be run through a web browser as opposed to being shipped on CDs or digitally to customers to run on their own computers. And subscriptions are merely the payment method. These two concepts are so tightly related that a reference to SaaS today almost always refers to both the delivery and payment method.

It's hard to overstate the magnitude of this earthquake and the impact it has had on the software industry and the ripples it's creating beyond software. SaaS (referring to both components) has changed the way everyone thinks about software, from Wall Street to Main Street. Take finance, for example. SaaS requires the need to reconsider almost everything about the way company financials are kept and reported. Revenue is no longer king but has been replaced by annual recurring revenue (ARR). Profitability in the SaaS world is no longer feasible to expect in the first few years of a company's life because the up-front costs incurred to acquire and implement a new customer are so large while the monthly payments are comparatively small. But Wall Street has recognized the long-term value of a growing installed base that keeps paying for the software month after month and year after year. Check out the market caps for public SaaS companies such as Salesforce, HubSpot, and Box and compare them to the metric that used to be the stock investors' primary indicator of a company's worth—earnings per share (EPS). EPS for the companies just mentioned are mostly nonexistent because there are no earnings. And yet those companies are valued anywhere from $2 billion to $50 billion. Why is that? It's because they all have a growing set of existing customers who never stop paying for the software and who get more profitable every year they remain a customer. Wait a minute. Remember the Salesforce story with which we started the book? There's no guarantee that it's a growing set of customers who never stop paying. That's where customer success comes in.

Perhaps the most important effect of all of this—SaaS as a delivery method and subscriptions as a payment method—is that much of the power in the B2B transaction has shifted from the vendor to the customer. Think about it. The customer no longer has to buy the hardware or the software, set up and run data centers, or hire expensive people to manage all of it. They simply lease the whole package from the vendor. That also means that they can stop using it and paying for it almost any time they want. For the customer, this dramatically reduces both the up-front costs and the risk of acquiring a new solution as those costs and risks shift over to the vendor. True, there are still typically some switching costs in changing SaaS solutions but nothing like what it was in the past with perpetual-license software. At the extreme, to use a B2C analogy, it's like switching from Amazon.com to BarnesandNoble.com (both SaaS solutions) to buy a book. If you are an Amazon customer, you have probably given it your credit card info, all the

addresses where you ship books, plus you've learned how to navigate the website (product) to find and purchase what you want even to the point of one-click buying and "free" shipping through Prime. That means there's some pain in deciding to purchase your next book on BarnesandNoble.com instead. You'll have to figure out how to find the book you want, put it in your shopping cart, and then go through the checkout process, providing your credit card information and shipping address. It may not be terribly painful, but it's not quite free either. The complexity and costs of switching B2B software solutions are much higher than the consumer example, but, as we've said before, it's far more doable (and likely) today than it was in the old enterprise software world. This risk is now owned almost exclusively by the software vendor.

The rise of the Internet, with easy access to virtually all the information in the world, is the culprit here. Let's examine the process of buying a new car as another illustration from the consumer world. It used to be that most of the car-buying process was controlled by the car company and specifically by the salesperson. We learned most of what we came to know about the car from him. We understood the features and options and which ones came with which package by talking to him. We negotiated the final price *only* by talking to him (and his boss). In short, control of the entire process was very much in the hands of the salesperson. Now fast-forward to 2015. Our research on the car we want is done on the Internet. We can literally get the entire bill of materials for the car if we wish. We can find out the prices from a variety of dealers, how much the value of the car will depreciate in the first year or two, how much the dealer will get in kickbacks from the manufacturer, as well as something your salesperson could not possibly know—how well that car is liked by 10 of our Facebook friends. By the time we decide to walk onto the lot for a test drive, we know more than the salesperson does about that car. The Internet has shifted the power from the dealership and the salesperson into our hands. Revolutionary.

The process of purchasing B2B software has been irrevocably altered in much the same way. The up-front costs are lower, the resource requirements are reduced, the commitment level is diminished, and the switching costs are far less than in the past. Plus, there is no shortage of access to others who have purchased and used the solution, many of whom you may know directly. Once again, the power has shifted in a dramatic way from the seller to the buyer.

And isn't this the way the world should work? Shouldn't the buyer be more in control than the seller? Shouldn't a solution have to work for the customer in order for them to continue to pay for it? Shouldn't it be relatively easy to switch to what you think is a better solution if you choose to? Shouldn't the vendor have to earn your business every month and every year? Of course, of course, of course. This is the way the retail world has always worked. If you don't like your experience at Macy's or you don't think you got value for your money, you don't have to go back. You aren't locked in to buying all your clothes from Macy's because you signed a contract three years ago and paid them $32,000. You can just walk over to Kohl's and give them a try. Your Macy's credit card won't work over there, but that's a minor inconvenience for a better solution or an improved experience.

Let's take a pause for a quick SaaS financial tutorial because it's relevant to everything else in this book. We made mention earlier to ARR as the primary measurement of a SaaS company's business. ARR stands for annual recurring revenue. It's also often referred to as ACV, or annual contract value. By either acronym, it is simply the annualized amount that customers are paying on a recurring basis for the software. If a company has 20 customers all paying $1,000 per month, the company's ARR is 20 × $1000 × 12 or $240,000. If a company has six customers all on two-year contracts worth $2 million each, that company's ARR is 6 × $2 million/2 or $6 million. Total company ARR, or ACV, is an assessment of the annualized value of the installed base. Many companies look at these same numbers monthly instead of annually and that's referred to as MRR.

Without trying to provide you with an MBA in SaaS finance, there's one more thing that has to be understood here because it leads us to the reason for this book and that is the changing value of that existing set of customers. In a perfectly predictable world using our previous examples, the 20 or 6 customers of our theoretical companies continue to be customers and pay their $12,000 or $1 million per year. Now that's perfectly predictable but not perfect by any means. In a perfect world, those customers actually pay you more money every year either because prices go up, discounts go down, they buy more licenses, or they buy additional products from you. That's how a company with $6 million in ARR could become a company with $8 million of ARR *without ever selling their software to another new customer.* This is an important and fundamental element of a successful subscription-based company—growing the value of the installed base.

Unfortunately, as with most things in life, there's an opposing edge to that sword. The value of your installed base can also shrink. Customers decide they no longer want to be customers (the Salesforce story). Customers negotiate deeper discounts when they renew their contracts. Customers may stay customers but give you back a product or licenses. All of these actions reduce your ARR as a company. As a whole, this is called *churn*. Churn is simply a measure of dollars that used to be part of your ARR that no longer are. Churn is also often used to refer to a customer that is no longer a customer. That becomes a *customer who churned*. In the broader sense of the reduction in ARR, these are referred to as churned dollars.

So at last we are approaching the heart of the matter—the management of your installed base. Growing your recurring revenue and reducing churn. You see, there is no world where these things happen without some kind of intervention or, at the very least, nurturing. Customers and vendors tend to drift apart if neither party takes any action. They are like two boats side-by-side in the middle of a lake but with no one in either boat. Inevitably, those two boats will not remain side-by-side, and probably not even in proximity. Someone has to be in at least one of the boats, preferably both, and with oars to keep them next to each other. In our SaaS world, and every recurring revenue business, this is no longer just a nice idea. It's an imperative.

Perhaps the most significant advantage of SaaS for the vendor is that it tends to expand the market for your products. With both the up-front cost and the time-to-value dramatically reduced, more and more companies become part of the target market. And few things increase a company's value more than an expanding addressable market. Using Salesforce as an example again, we've already touched on the cost component. But what about the time-to-value equation? An implementation of Siebel in 2002 might very well have taken 18 months or more. Construction of the data center, installation of the hardware, and then the complex installation, configuration, and customization of the application were part of the landscape for every customer. Some would have felt very lucky to be completed in 18 months. With Salesforce, you can literally go to their website, provide a credit card, get a login, and be putting accounts, contacts, and opportunities into the system in less than an hour. A functioning CRM system in 60 minutes?

Figure 1.1 No Software Logo

Unimaginable before SaaS. Salesforce took the idea to the extreme, even incorporating the concept of "no software" into their logo (see Figure 1.1).

There were other companies early to the SaaS party, NetSuite among them, who were also standing on Paul Graham's shoulders and making this new model enterprise-viable. Despite other SaaS companies popping up around the same time, Salesforce's success and style got people's attention, and its IPO in 2004 left little doubt that the software business model had changed forever. And for good reason. Investors were not rewarding Salesforce because the idea of SaaS was unique. They were rewarding Salesforce because the model worked. But for it to *really* work, as we've already discussed, churn has to be controlled, and the vehicle for controlling churn is called customer success. And when SaaS's most successful company built a customer success team and started talking about it publicly, it gave permission to all other subscription-based businesses to do the same. And the customer success movement began.

As we mentioned earlier, in the days prior to SaaS and subscriptions, B2B software was sold on a perpetual license basis and that meant big up-front payments. With SaaS, the equation is turned upside-down. It is not uncommon for the initial financial commitment by a customer to a SaaS company to be less than 10 percent of the expected LTV of that customer. In the case of a monthly subscription business, that number may well be less than 1 percent. Let's look at a vendor who offers its software on annual contracts, and let's say a customer pays for the first year up front to the tune of $25,000. Now, assume the customer remains a customer for eight

years. That means they'll have to renew that one-year contract seven times and, if you build in an annual growth rate of 7 percent for the increase in price and additional licenses and products likely to be purchased, you'll see that the LTV of that customer will exceed 10 times the initial outlay. This, then, is the definition of the term we've been throwing around, LTV. LTV is the total dollars a customer spends (or is expected to spend) with a vendor during their relationship and is another key metric for a SaaS company.

For most software companies, the cost of acquiring a new customer is very high. All of the marketing expenses required to generate leads and then the cost of expensive sales teams to convert those leads into real customers adds up. In addition, the costs associated with getting customers up and running with a fully configured solution can be heavy and are obviously front-end weighted. In most cases, it takes 24 months or more of subscription revenue just to recover the cost of acquisition and onboarding. If customers are on annual subscriptions, as is often the case, they need to renew their contract with a vendor at least twice in order for the vendor to break even and start making a profit. Churn greatly exacerbates this challenge. And the urgency is even higher because most churn happens in the first couple of years because of the complexity of onboarding and adoption. CEOs of SaaS companies have learned very quickly that customers really are king and that real investment is required to make them successful and to retain them for long periods of time. That's the financial imperative for all recurring revenue businesses and the impetus for customer success.

Customer success is really three different, but closely related, concepts:

1. An organization
2. A discipline
3. A philosophy

At its essence, customer success is the organization that focuses on the customer experience with the goal of maximizing retention and LTV. Only if this is done effectively can a subscription company survive, and market domination comes only to those who do it exceedingly well.

Customer success has also become a new discipline. Like any other discipline—sales or product management or customer support—there are groups and forums and best practices and conferences created to support and nurture this new craft and its practitioners, into a place alongside the other

necessary roles in a successful company. Individuals practicing the discipline of customer success are often called customer success managers (CSMs) but can be found with a variety of titles, including account managers, customer relationship managers, customer advocates, and client specialists, among many others. In this book, we'll often refer to CSM as the generic term covered by all of those titles.

And last, customer success is a philosophy, and it must pervade the entire company. No organization, or job role, can function in a vacuum, and customer success may be the best example of this. It requires a top-down, company-wide commitment to truly deliver world-class customer success.

It is these three principles that are the focus of the remainder of this book.