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Technology, Media, and Telecommunications

How quote-to-cash excellence can fuel growth for B2B subscription businesses

Outperformers achieve higher growth by carefully considering the sales journey and balancing rigorous process discipline with the flexibility to meet individual customer needs.

by Bibhudatta Dash and Richelle Deveau

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Driven by enthusiasm from customers, providers, and investors, subscription-based B2B business models are on the rise across sectors, from financial services to manufacturing. Yet as they roll out a myriad of subscription offerings, many organizations find that their internal processes and systems can't keep up with the customer expectations and operational realities of subscriptions, and as a result hinder growth. One such critical process to examine and reinvent is the end-to-end quote-to-cash (QTC) process of quoting, contracting, invoicing, collections, and renewals.

Managing complexity in the QTC process requires coordination across multiple functions including sales, pricing, finance, legal, operations, and customer success. The challenges of coordination are even more acute for companies managing a hybrid commercial model of traditional and subscription sales. This often includes juggling multiple disparate quoting processes, data models designed for SKUs instead of subscriptions, and frustrating invoicing practices.

Optimizing QTC for growth requires a series of concerted design decisions and trade-offs across the end-to-end journey. At the highest level, it involves striking the right balance between standardization and customization.

Standardize

Standardize a process for simplicity: High-performing subscription companies understand the complexity of orchestrating action across multiple functions. Standardizing the majority of the QTC process allows companies to build a robust core of simpler, automated actions that create less friction and complexity as orders are handled.

Customize

Customize to offer flexibility: A simpler process, however, doesn't necessarily have to be rigid. B2B subscription businesses recognize the importance of offering flexibility where it truly matters to customers, as long as doing so doesn't require too much manual work or open the process to errors.

Failure to carefully consider every design decision in the QTC process can be costly. Take the case of one fintech company that decided to move into the subscription business without making deliberate choices in the end-to-end journey. Six months into the launch, the feedback from sales was that the process was plagued by bottlenecks, requiring some 200 emails to move a quote to an invoice. The sales team had to generate quotes manually. The ordering team did not know how to process orders. The entitlements system was not ready to store subscription information. And all invoicing was performed manually. With no clear direction on enterprise-wide choices, each salesperson was left to shepherd their deal through multiple functional teams. Though customers were excited to embrace the new subscription model, the inability of scaling it put growth plans on hold. The organization ultimately had to send a cross-functional team back to the drawing board to identify explicit enterprise-wide design choices for each step in the QTC process.

In our experience, cases like this are more the rule than the exception. To understand how higher-growth B2B subscription companies avoid such disastrous consequences and optimize the choices in their QTC process, we mined three years of performance data from nearly 500 companies and compared indicators such as revenue growth, expansion, and net retention against 30 metrics corresponding to design choices in the quote-to-cash process. (See the sidebar, "About the research.")

Our research validated something organizations often express anecdotally, which is that complexity in QTC is associated with slower sales motion, poor customer experience, and ultimately decreased ability to grow. Higher-growth companies consistently demonstrate a set of QTC practices that help minimize internal friction through standardization and yet retain the flexibility to meet the critical needs of customers. While it is difficult to establish a causal link between QTC practices and growth, B2B subscription businesses that optimize their QTC processes have greater success in adding new accounts, growing existing accounts, and reducing customer churn. As a result, these high-performing companies grow their annual recurring revenue (ARR) at four times the rate of others.

About the research

The research was conducted by McKinsey & Company in collaboration with the Subscribed Institute, the research wing of Zuora, a software vendor for subscription companies. The dataset was derived from Zuora's Subscription Economy Index^{TM} (SEI) database, which tracks subscription business volume, as well as the prevalence of various pricing and packaging practices. The SEI consists of anonymized and aggregated, system-generated activity on the Zuora billing service, and metrics derived from it are meant to be indicative of subscription-based business in the broader economy.

The initial data extract included at least three years of consecutive operations for approximately 500 companies across a wide range of industries. The analysis focused on approximately 30 metrics along the end-to-end quote-to-cash process. For the research published in this article, we focused on a subset of companies—three-quarters of which are in the technology, media or telecom (TMT) sectors—that had average revenue per account (ARPA) of more than $5,000 and annual recurring revenue (ARR) of more than $75 million. Further, we split this subset into two cohorts: higher-growth companies with more than 20 percent annual revenue growth, and lower-growth companies with less than 20 percent annual revenue growth. The higher-growth cohort had higher average ARR ($260 million versus $160 million) and higher ARPA ($70,000 versus $25,000), but comparable number of customer accounts (approximately 10,000).

We compared the two cohorts across the 30 QTC-related metrics and validated differences in performance by testing for statistical significance.

Design choices in the quote-to-cash process

When designing a quote-to-cash process, the design choices and trade-offs that need to be made fall into four main categories: offering architecture, order management, run complexity, and contact intensity (Exhibit 1). For each of these broad categories, there are a number of questions that must be asked revolving around some of the most critical issues.

Offering architecture refers to the choices companies make around the portfolio of products and pricing: For instance, should the product catalog be curated into well-packaged bundles or serve as an aggregation of individual products sold? Should offerings be priced using a standard, limited set of tiers or should
pricing be tailored to the specific needs of customers?

Order management refers to choices around flow of deals/orders requiring internal management approval, such as: What terms and conditions should be tightly governed versus flexibly tailored to customer needs? What should be the length of payment terms? Should subscription offerings have shorter length-of-payment terms?

Run complexity refers to choices around capabilities of back-office billing and payments, including: Should companies offer value-based billing? What level of invoicing and collection automation should companies require?

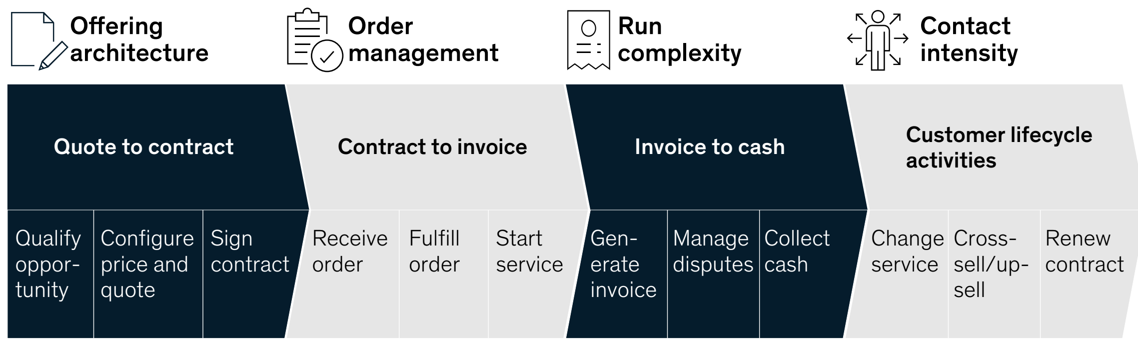
Finally, *contact intensity* refers to the choices around supporting customers throughout the subscription lifecycle: What renewal methods should be offered? How frequently should customers be allowed to scale up or scale down?

Examining QTC attributes: Standardization versus flexibility

Answering this range of questions is no simple task. Our research, however, provides a quantitative-based guide for how to approach several of the most important quote to cash decisions, choosing where to standardize for simplicity versus where to provide flexibility.

Exhibit 1

When designing a quote-to-cash process, the choices that need to be made fall into four main categories.



Offering architecture

Starting with this category, simplicity is the preferred approach, and it can have great impact through the product catalog and pricing tiers.

Standardize

1. Product catalog. Product catalogs proliferate when they are not actively managed, potentially causing speed to market to suffer. Disciplined, active catalog management encompasses a broad set of practices such as removing redundant products, periodically evaluating bundling choices, and associating add-on products with core products. We find the revenues of higher-growth companies are typically concentrated in a smaller set of products. Their complete catalogs aren't necessarily smaller however—rather, they curate products into meaningful product bundles based on the needs of different customer segments. As a result, these same companies achieve greater penetration of their product catalog (Exhibit 2).

Standardize

2. Pricing tiers. From the quote-to-cash perspective, pricing tiers represent the willingness of a business to segment services and make demands on the back office to meet the varying needs of each customer segment. Therefore, the more pricing tiers a business has, the greater the demands on the back office to support the different service levels for each tier. The question then becomes, Should you limit the number of pricing tiers to reduce back-office complexity? Our research strongly suggests the answer is yes, since higher-growth companies have fewer pricing tiers. In fact, higher-growth companies have one-third fewer rate plans per active product than lower-growth counterparts (11 pricing tiers per active product versus 17). While these companies do use pricing tiers to segment customers to a certain extent, they don't go so far as to create so many pricing tiers that they become a de facto alternate discounting mechanism.

Order management

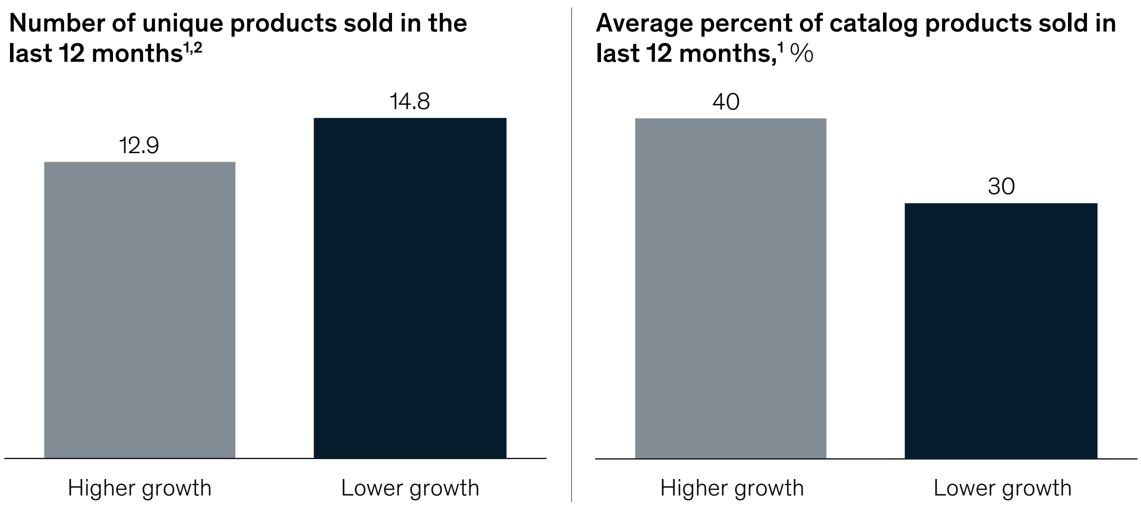
When it comes to the next category, companies walk a fine line between simpler repeatable process and flexibility to accommodate customer needs. This is most evident when dealing with payment terms.

Standardize

3. Payment term length. In recent years subscription payment terms across industries have been increasing as customers tighten accounts payable policies to help manage working capital. As a result, payment terms have become one of the more fiercely negotiated aspects of a contract. The question companies grapple with is whether to try to counteract that pressure from customers or simply yield to it. Higher-growth companies these days have payment terms of an average of 18 days, as compared to 22 days for lower growth peers. We believe the shorter payment terms are a result of better sales compliance with internal policies and practices, and clearer articulation of the subscription value proposition to customers.

Exhibit 2

Higher growth companies' revenues are typically concentrated in a smaller, curated set of products, while their full catalog achieves greater market penetration.



[1]Analysis conducted based on data of companies with ARR >$75M, ARPA >$5K and at least 3 consecutive years of data from 2015-2019. Higher growth cohort had >20% annual revenue growth, while the lower growth cohort had <20% annual revenue growth.
[2]Effective number of unique products calculated based on relative proportion sold. Calculated as sum of 1/(percent of revenue from product i)^2 where i is the total number of unique products for a company.
Source: Zuora Proprietary data, McKinsey analysis

Customize

4. Payment term options. Ordinarily, a limited set of payment terms lends itself to collections simplicity and more predictable free cash flow. In contrast, offering a wider variety of payment terms introduces more back-office complexity to manage and requires investment to offset it, in the form of manual effort or additional automation. Is it worth the investment to offer the customer greater flexibility? Our data shows that higher-growth companies offer 45 percent more payment terms, demonstrating a willingness to accommodate the unique needs of customers, such as working capital requirements, or strict account payable guidelines (Exhibit 3). These higher-growth companies invest in automation to offset the complexity and reduce drag on collections operations.

Run complexity

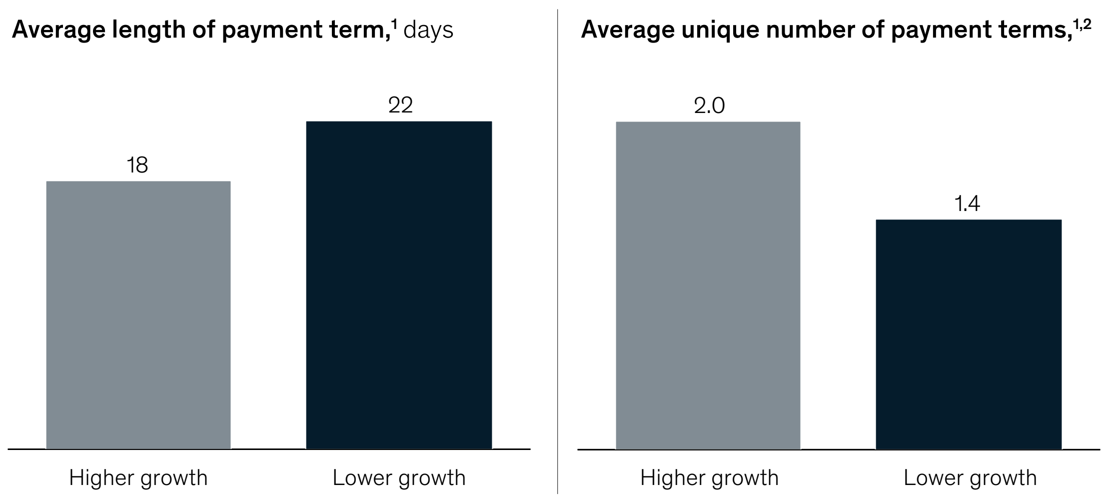
Most higher-growth companies rely on back-office automation to manage the quote-to-cash process, but optimizing automation involves multiple decision points. First, there is an imperative to digitize traditional ways of doing business with tools such as e-invoicing and e-payments. Then there are digital capabilities that determine what type of subscription offering one can take to the market. For example, when companies decide to adopt usage-based subscription models, they accept by default the IT investments required to measure usage and share that information with customers on an ongoing basis.

Customize

5. Invoice format, delivery and payment methods. One of the key stumbling blocks with invoicing and payments is that customers often have unique needs, such as a certain format or posting to a specific customer portal, that must be met before they are able or willing to pay. Others may require some level of customization, with certain fields or data elements included on the invoice for approval purposes. Our analysis found higher-growth companies generated nearly 90 percent of their invoices in a digital format (such as PDF), 10 percentage points greater than their lower-growth peers. This is just one aspect of billing and payments automation, which also

Exhibit 3

Even as higher-growth subscription companies do a better job of maintaining shorter payment terms, they are more flexible in offering their customers a greater number of terms.



[1]Analysis conducted based on data of companies with ARR >$75M, ARPA >$5K and at least 3 consecutive years of data from 2015-2019. Higher growth cohort had >20% annual revenue growth, while the lower growth cohort had <20% annual revenue growth.
[2]Unique number of payment terms calculated based on relative proportion sold. Calculated as sum of 1/(percent of revenue from payment term i)^2 where i is the total number of unique payment terms for the company.
Source: Zuora Proprietary data, McKinsey analysis

includes the calculation of the invoice total and choice of payment method. Overall, it enables companies to align to changing technology standards while providing maximum flexibility and meeting a greater set of customer needs.

Similarly, an increasing number of customers prefer electronic payment methods. Higher-growth companies respond to this need by accepting multiple modes of payment, such as ACH, credit card, or e-check. Consequently, they receive greater than 50 percent of their payments through electronic methods, compared to 21 percent for other companies.

Customize

6. Billing methods. Customers are increasingly demanding a shift from flat monthly pricing models to those that align better to the specific business value of the purchase. For example, user-based, usage-based, or consumption pricing models allow the customer to only pay for what they use. To support invoicing of such value-based pricing models, subscription companies need the capabilities to accurately meter usage and rapidly and clearly explain the usage to the customer. Higher-growth companies lean into customer demands with flexible billing at a significantly higher rate than their peers. Our research shows nearly three-quarters (73 percent) of revenue from higher-growth companies comes from value-based billing, compared to only 44 percent of lower-growth companies (Exhibit 4).

Contact intensity

In this last category, subscription businesses, by their nature, must have frequent customer touchpoints throughout the life cycle, including the trial, trial conversion process, initial ordering and contracting, scale-up and scale-down of users or usage, and renewal management. As these different touchpoints add varying degrees of value to the customer relationship and experience, companies must prioritize which ones will drive the most growth.

Standardize

7. Renewal management. Of the three standard approaches to renewal management—sales-led, evergreen with no contract expiration, and auto-renewal, typically with a set number of automatic extensions—the sales-led option adds significantly more contact intensity, time that could be otherwise used to help customers derive greater value from the products. Many companies often can't explore evergreen or autorenewal due to customer policies and preferences, variability in pricing, or lack of IT capabilities. Higher-growth companies, however, have still found a way to make a frictionless renewal process the standard, in part by making the necessary technology investments or simply making it more of a priority. They enjoy a greater rate of evergreen or auto-renewals, 81 percent compared to 59 percent for lower growth companies (Exhibit 5). These contract terms, as one might expect, support greater customer retention: Among all the subscription companies we looked at, 84 percent of those in the top quartile by retention offered some form of auto-renewal compared to 14 percent of companies in the bottom quartile.

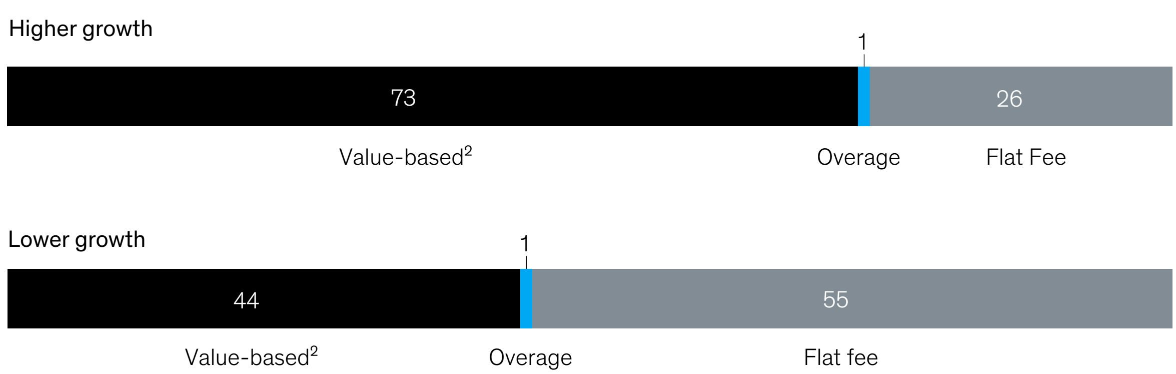
Customize

8. Subscription changes. Customers generally want the ability to flex their subscriptions up or down based on different business needs at any given time. This can include changes in pricing tiers, bundles, number of users, or usage requirements. While enabling customers to scale up or down is a critical part of the subscription life cycle, companies still must wrestle with how often to allow it and under what policy safeguards. Our data

Exhibit 4

Customers increasingly want to shift from flat fee to value-based pricing where they only pay for what they use, and higher-growth companies are doing a better job of meeting that need.

Average percent of revenue by pricing model,[1] %



[1]Analysis conducted based on data of companies with ARR >$75M, ARPA >$5K and at least 3 consecutive years of data from 2015–2019. Higher growth cohort had >20% annual revenue growth, while the lower growth cohort had <20% annual revenue growth.
[2]Value-based billing includes per-unit and usage pricing models.
Source: Zuora Proprietary data, McKinsey analysis

shows that higher-growth companies are more flexible in allowing changes to subscriptions. Nearly half (46 percent) had at least one change per subscription compared to 35 percent for lower growth companies. In addition, subscriptions in higher-growth companies had 1.4 changes during the average lifetime of the contract of 24 months, compared to 0.8 changes for lower-growth companies.

Implications of research on broader QTC process design

While we evaluated eight attributes critical for quote-to-cash, we can also extend our findings to other design choices across the end-to-end process. Many companies take a bootstrap approach to quote-to-cash and refuse to make clear choices up front about standardization and flexibility. This leads to internal waste, as every deal and order gets debated afresh on what should and should not be provided to the customers. Based on our work with best-in-class practices, we recommend companies take a two-pronged approach to designing their entire quote-to-cash process:

Create a standard pathway with high automation. Start by designing and documenting a standard process pathway for deals and orders to flow through with very little approval or rework loops. The pathway should ensure at least 80 percent of the orders can be processed in a rapid, direct manner with little or no intervention. Standardization is the preferred answer for design decisions that:

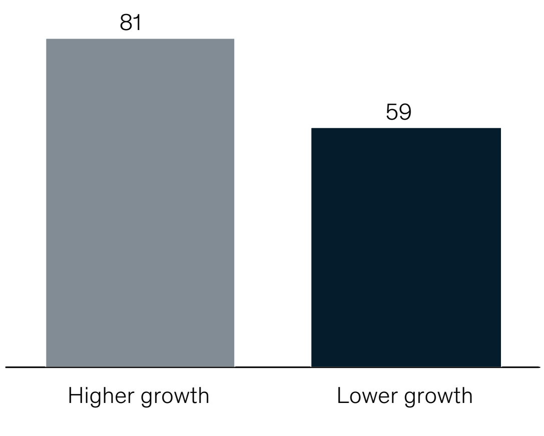
— Do not make a significant difference to customer experience

— Place disproportionate burden on the back office to support variations

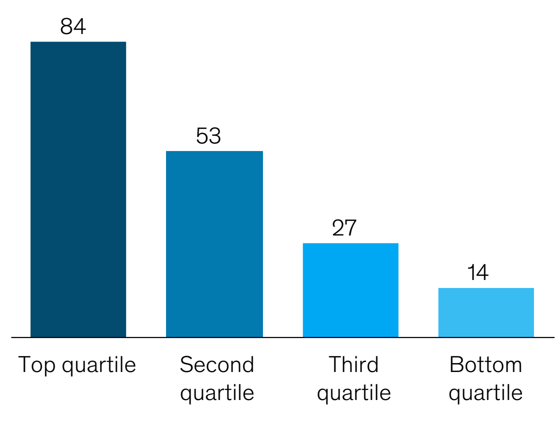
Exhibit 5

Higher-growth companies are able to get more of their customers on evergreen or auto-renewal deals, which help boost retention.

Percent of subscribers on auto-renewal and evergreen,[1,2] %



Percent of companies offering some form of auto-renewal, by retention quartile,[1,3] %



[1]Analysis conducted based on data of companies with ARR >$75M, ARPA >$5K and at least 3 consecutive years of data from 2015–2019. Higher growth cohort had >20% annual revenue growth, while the lower growth cohort had <20% annual revenue growth.
[2]Two sample t-test performed; observed difference of 12% is not statistically significant at the a<0.1 level.
[3]95th confidence intervals calculated, indicating statistically significant difference across quartiles.
Source: Zuora Proprietary data, McKinsey analysis

— Have fairly well-accepted norms in the industry
— Can be largely addressed with common technology solutions and features

Standardizing a QTC process is not easy. Companies will have to address concerns around revenue loss, compliance risks, and customer satisfaction. Defining this process is a cross-functional effort, and difficult choices will need to be made and adhered to once the design is implemented.

Take for instance a global information services company that earns more than 85 percent of its business from subscriptions. The company had twice failed to implement a configure-price-quote (CPQ) software solution because the processes across different business units were never harmonized. On their third attempt, the company created, prior to software implementation, a global process pathway to serve all business units. The process design relied upon extensive customer interviews to identify current gaps and build a shared vision. Various cross-functional sub-teams worked for three months to define the process, policy, and associated digital customer experience. Executive leadership was actively engaged in making critical trade-off decisions.

The process design work involved breaking down the CPQ and billing software implementation into a meaningful subset of use cases, which the IT team could make progress on gradually. At the end of 18 to 24 months of QTC overhaul, the company achieved a 20 to 40 percent improvement in speed to contract, order provisioning, and invoice accuracy. Beyond process improvement, the standard pathway provided the company with consistent data, real-time visibility into performance, and the ability to manage through predictive analytics like churn prediction, pricing, and next product to buy.

Empower sales executives within the 'zone of flexibility.' There are many design choices where taking the more flexible path creates additional value for both the provider and the customer. Still, the decision to provide flexibility may bring with it incremental costs of processing and a quality risk associated with managing exceptions. For this reason, providers should be judicious about where they offer flexibility. Flexibility becomes a preferred option when:

— It provides significantly more value to customers, or a sub-segment within the customer base
— The capability is a source of differentiation for the company
— It is a critical part of the brand promise
— There are significant differences in local markets, especially for serving small and mid-sized businesses

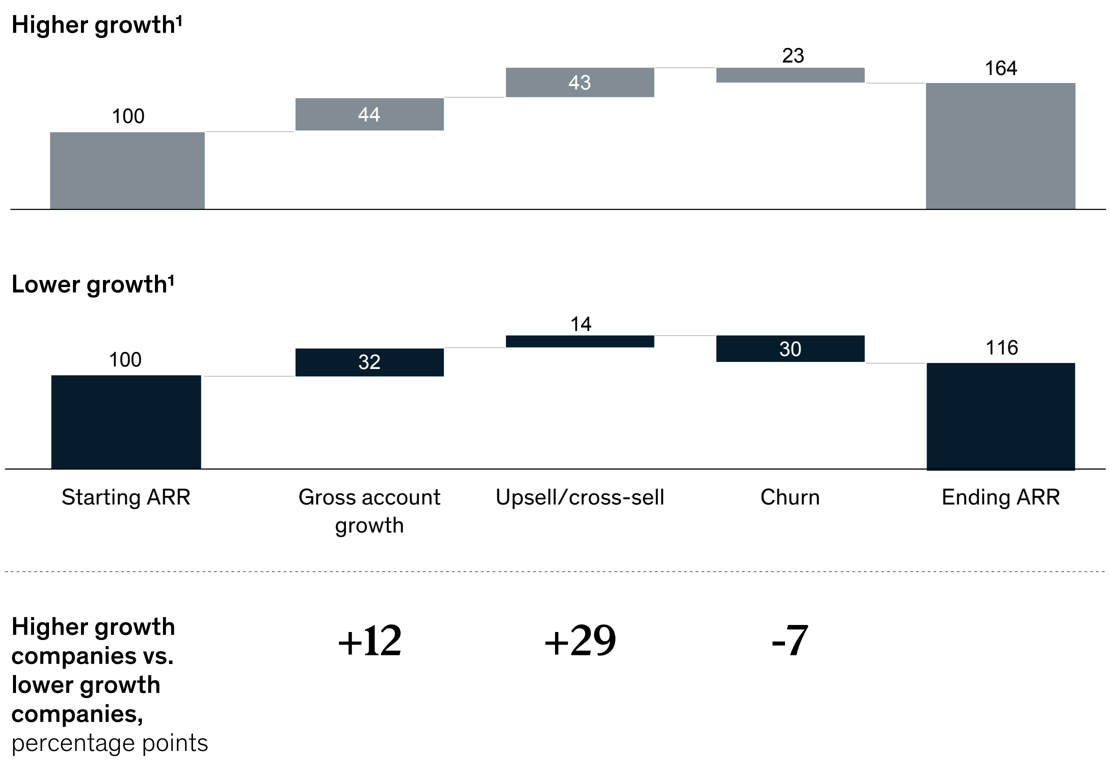
Consider a software company whose portfolio mushroomed into more than 300 products within the first year of launching its B2B subscription offering. Because each deal was unique and each salesperson strived to make a sale, the corporate office put significant approval loops in place. While it was essential to have a certain level of control, the extent of their approvals created a logjam for sales teams trying to close deals. To break it up, the company revamped its approach to bid management and beefed up its bid desk with people experienced in subscription sales. They then recalibrated and offered clear guidance for what the sales team could and couldn't offer to customers. In one example, legal provided sales with preapproved terms and conditions they could replace in the original contract without further legal approval. Offering greater flexibility in deal approvals enabled the company to improve deal velocity and win rate by 5 to 10 percent over the next six to 12 months.

The rewards of higher-growth B2B subscription strategies

Companies that strike the right QTC balance between organizing around a robust core while offering customers flexibility where it most matters to them tend to dominate performance across all three drivers: adding new accounts, growing existing accounts, and reducing customer churn (Exhibit 6).

Exhibit 6

B2B subscription businesses that optimize QTC grow four times as fast as their peers by adding new accounts, expanding existing accounts, and reducing customer churn.



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Source: Zuora Proprietary data, McKinsey analysis

At a time when the stakes are rising and the demand for B2B subscription services is growing, organizations must ensure all areas of the end-to-end sales journey are aligned with a series of careful design decisions. While organizations typically view QTC as a tool to speed up cycle time, improve efficiency, and reduce costs, it can also be a powerful growth driver. Creating a quote-to-cash process for a B2B subscription business can be a complex undertaking, but those that adopt best practices to design their process to fire on all cylinders across each attribute can achieve a sustainable competitive advantage.

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