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Analyzing Sources of Revenue Can Bring Insights Into Growth

Discussions of increasing company revenues typically focus heavily on increasing efforts to obtain new customers. Most companies don't really manage top-line growth. Management allocates resources to sales efforts they believe will be most productive and hope the economy cooperates. But a growing number are taking a less passive approach, and studying revenue growth more carefully. Quantifying the sources of revenue can yield a wealth of information, which results in more targeted and more efficient deployment of resources, capital, and decision-making and, therefore, increased returns on investments in sales and marketing.

To determine revenue sources, companies are beginning to use a sources-of-revenue statement (SRS) that was developed by Michael Treacy, author of *Double-Digit Growth* and co-founder of consulting firm GEN3 Partners, in Boston. Treacy's model breaks revenue into five categories:

1. Continuing sales to established customers (known as base retention).
2. Sales won from the competition (share gain).
3. New sales from expanding markets.
4. Moves into adjacent markets where core capabilities can be leveraged.
5. Entirely new lines of business unrelated to the core.

The basic method of compiling the SRS is fairly straightforward and most of the information needed is readily available. But the effort does require two estimates: (1) an accurate measure of how fast the market is growing, and (2) customer churn rates. When companies look at the amount of revenue coming from each of the five sources, and the changes in each over time, they can spot opportunities or weaknesses and allocate capital and resources more effectively.

The basic problem with the traditional way of viewing revenue is that it doesn't carve out how much is produced by growth in the overall market. Companies that don't understand that their revenue growth is coming only from market expansion can be lulled into complacency. And once their market matures and growth slows, they're left unprepared.

An SRS revenue discipline starts with a look at year-over-year growth in the five categories. When estimates of market growth and churn rates are not readily available, obtaining data will require a combination of internal and outside research.
Companies also find it beneficial to apply its SRS not only to revenue but also to margins. As it is not enough to simply grow revenue organically — businesses want to grow where they are most profitable.

The results of the SRS are a company gaining a better idea of its true sources of growth and profitability. Management can utilize this information to make better decisions about where to allocate its sales and marketing capital and resources. For example, companies have learned from its SRS analysis that, in some cases, focusing on current customers and markets derives more top-line growth and profitability than chasing new ones.
Companies can also tie the SRS model into its compensation structure. For example, salespeople could be compensated more for growing market share than for market growth and it could also be used to encourage customer retention.

How to Create an SRS

To product a sources-of-revenue statement (SRS), five steps are required — in addition to establishing total revenues for comparable periods.

1. Determine revenue from the core business by establishing the revenue gain or loss from entry to or exit from adjacent markets and the revenue gain from new lines of business, and subtracting this from total revenue.

2. Determine growth attributable to market positioning by estimating the market growth rate for the current period and multiplying this by the prior period's core revenue.

3. Determine the revenue not attributable to market growth by subtracting the amount determined in Step 2 from that determined in Step 1.

4. To calculate base retention revenue, estimate the customer churn rate, multiply it by the prior period's core revenue, and deduct this from the prior period's core revenue.

5. To determine revenue from market-share gain, subtract retention revenue, growth attributable to market positioning, and growth from new lines of business and from adjacent markets from core revenue.

If you need assistance creating or implementing your SRS, please contact Harvest CFO Consulting by telephone 724-934-4752, or e-mail dhillier@harvestcfo.com. Also, please visit our website at www.harvestcfo.com.

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