



## **Flashpoint**

# Flexible Consumption Business Capabilities

What are the capabilities, skills, and knowledge needed to support consumption-based models in an as-a-service economy?

# When you move to a flexible consumption model, you need a new set of capabilities and skills

## Technology, media, and telecommunications (TMT)

companies are currently in the midst of a fundamental shift to **flexible consumption** in which customers are able to access, consume, and pay for offers and services based on need and usage. To make a successful **transition**, companies will not only have to change how they deliver their offerings but also determine what new capabilities, skills, and knowledge they will need.

Flexible consumption can take a variety of forms, from subscriptions to subscriptions plus overages, to pure pay-per-use arrangements and other recurring revenue models. These models are profoundly different from traditional business models and will require a different set of business

capabilities. If you are moving to a flexible consumption model, you will need to look across your entire organization to identify where the capability gaps are and determine where adjustments should be made.

Often the capability discussion focuses on the “quote to cash” cycle, but this is only part of the picture. Depending on the specific type of consumption-based model selected, you will need new capabilities across the entire value chain, including the areas of offer management and delivery, pricing, sales and marketing, sales compensation, service operations (including service fulfillment), billing and invoicing, revenue recognition, taxation, contract compliance, and investor communications. Changes to these

capabilities will have implications for business processes, organizational design and talent, and both operational and IT systems.

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## **About *Flashpoints***

Every day brings new ideas and possibilities to the Technology, Media, and Telecommunications sectors. *Flashpoints* is your tool for gaining the context you need to make sense of these critical developments—as they emerge.

# Key observations



## Offer management and pricing: The benefits of unbundling ... or rebundling

Offerings will need to be configured and priced based on new service business models and monetized based on value delivered to the customer.

## Customer success management: An emerging discipline

With recurring revenue models, the focus shifts from reactive service and support to proactive customer success management. Metrics and analytics will be central to understanding customer health, and companies will need to enhance post-sales capabilities to drive adoption, retention, and maximize cross-sell or upsell opportunities.

## Go-to-market: From multi-year deals to continuous customer engagement

Sales force and partners will require a different set of incentives that accommodate smaller upfront revenue streams and increase focus on growing customer consumption of offerings.

## Billing and revenue recognition: Now it's getting complicated

Flexible consumption changes how revenue is recognized, and the combination of traditional with flexible consumption models, along with the impending new revenue standard, will result in greater complexity.

## Contract compliance: Giving customers visibility into service usage

Major adjustments may be needed in how companies monitor customer compliance with the terms and conditions contracts, including giving customers the tools they need to monitor and adjust their service usage.

## Taxation: It's all about location

The location of technology infrastructure, and of critical employees, is increasingly determining taxation of flexible consumption offerings, making it challenging to manage global tax compliance.

# Offer management and pricing: The benefits of unbundling ... or rebundling

In the past, customers were forced to pay for a bundled set of features, even if they did not use them. But with flexible consumption, customers are given the option of paying only for the features they actually use. However, this increases the pricing dynamics for the vendor. Different flexible consumption models may also be offered for the same set of features, ratcheting up the complexity of offer management.

For example, a relatively simple consumption model is a subscription with a fixed monthly fee. A slightly more complicated version involves a base subscription with any usage over a set level priced based on the amount consumed. Other models might be priced based on specific advanced features used. Still others may provide tiered pricing – the more a customer uses the lower the unit price. Because the potential ways of combining and then pricing different features

and consumption plans are almost limitless, you need to be able to determine optimal monetization models. This will help control complexity in downstream processes such as billing.

The challenge is to be able to structure these offerings so that different features and attributes can be optimized and monetized. To do so successfully, you need to not only understand the “total cost of service” but also be able to determine which of these features can be offered as a service and how. This requires new, and far more intricate, pricing models, as well as the ability to manipulate them for optimal monetization.



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# Customer success management: An emerging discipline

Moving from traditional licensing to flexible consumption places a much sharper focus on efforts to ensure that the customer is effectively using and maximizing value from the offering—also known as customer success. Now, instead of relatively limited post-sale customer contact, there is a continuous customer engagement cycle in which a company and its customers share a single set of aligned goals.

Determining customer success calls for a more complex set of capabilities, which is why many companies with flexible consumption models are creating a customer success discipline within their organizations. Customer success professionals are tasked with monitoring whether customers have had a successful deployment, are using as much of the offering as they bought, and whether they are making the best use of all of the features.

To derive this level of insight you need sophisticated analytics capabilities that can create “customer health scores” based on a mix of customer satisfaction and other metrics. For example, offer usage metrics (e.g., number of active users, time spent per user, top features used etc.) can help you determine whether customers are happy with your offering or if there is a propensity to churn. Other metrics that can help your customer success professionals better manage client relationships are subscription renewal rate, retention rate or churn rate, annual recurring revenue (ARR), average customer acquisition cost (CAC), and customer lifetime value (CLV). You will also benefit from implementing analytic tools that can both predict customer behaviors and identify cross-sell and upsell opportunities.



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# Go-to-market: From multi-year deals to continuous customer engagement

When you move from large, long-term contracts to flexible consumption models, the transition has a major impact on how you compensate and train your sales force, as well as how you incentivize your channel partners. One option is to adjust compensation for the existing sales force so that it rewards the sale of multiple short-term offerings and additional features (upselling). Another option is to introduce a specialized sales force to overlay the existing sales force that is primarily responsible for selling the flexible consumption offering and delivering post-sales support. For sales force professionals selling flexible consumption offerings, you will need to adjust pay mix and payout mechanics to accommodate smaller upfront revenue streams and reward increases in customer offer consumption. You will also need to align your sales coverage models and roles with your new sales methods.

Partner engagement is another important capability for companies that wish to transition to a flexible consumption model. You need to be able to segment, prioritize, and train the right partners to drive flexible consumption offerings. This includes developing advanced partner self-service and other enablement tools that can provide such capabilities as automated quotes based on a range of customer needs. Creating new incentives is also important for gaining traction with emerging partner types such as independent software vendors (ISVs) and individual developers.



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# Billing and revenue recognition: Now it's getting complicated

There are a wide variety of billing arrangements for companies with flexible consumption models as their offerings have so many different permutations—from straightforward subscriptions to a combination of up-front payments, to pay-per-use. To complicate matters, they may provide customers with ancillary services, such as implementation assistance, training, and service maintenance. If these are billed separately, the result could be a combination of billing structures.

Regardless of how complex your billing structure is under the new model, it is important that you don't pass this level of complexity on to your customers. While different services and features can constitute separate line items, customers want consolidated invoices—even if they are consuming both traditional and flexible offerings simultaneously. For this reason you need the ability to aggregate usage and turn it into an error-free and easy-to-understand

bill. You also need to be able to support flexible billing terms, variable bill timing, and different payment options such as credit cards. Lastly, the bundling of ancillary services requires an assessment of whether additional units of accounting exist for each service.

Different consumption models can also place stress on your accounting system. The system should be sophisticated enough to accommodate the full variety of payment arrangements without forcing staff to revert to manual calculations. For example, the revenue recognition module needs to be able to determine the appropriate method for allocating an arrangement fee to each of the services you offer. Another consideration is the variable portion of the fee associated with the consumption model. For the module to work smoothly, you will need a mechanism for tracking detailed usage of every customer, since this will determine how you bill customers and recognize resulting revenues.



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Yet another challenge arises as a result of the [new revenue accounting standard](#) from the [Financial Accounting Standards Board \(FASB\)](#) and the [International Accounting Standards Board \(IASB\)](#), which will become effective for annual reporting periods beginning after December 15, 2017 for publicly held companies and for annual reporting periods beginning after December 15, 2018 for non-public entities. The new judgment-based standard creates an additional layer of complexity for companies transitioning to flexible consumption. Under the new guidance, there could be a change in the pattern of revenue recognition, as well as increased requirements for footnote disclosures. Companies will also need to consider how to account for the incremental costs of obtaining a contract, including commissions, and costs to fulfill a contract, which may need to be recorded as an asset and amortized.

As part of your transition to flexible consumption, you need to evaluate your existing accounting systems and controls to determine whether they can effectively handle the increased complexities, under

both current and impending new revenue guidance.

Finally, if you are converting to flexible consumption, you will need to strengthen your forecasting capabilities in order to estimate your future revenue stream as accurately as possible. Your investors, in particular, will want to understand how the transition to flexible consumption will affect future revenues, and being able to articulate the impact of the change will be critical to maintaining their confidence.





# Contract compliance: Giving customers visibility into service usage

Under traditional licensing contracts, vendors often audit customers to ensure compliance with the terms and conditions of their license and support contracts—a process that is not only intrusive but that has the potential to pit the two parties against each other. Under flexible consumption, the focus of compliance monitoring shifts to identifying opportunities to improve customer success. For example, if your customer is using more of your offer or service than outlined in the contract, you can either alert them to the fact so that they can change their behavior—earning their goodwill—or you can potentially sell them more capacity. Monitoring usage can also help you understand what additional features might benefit the customer, ultimately contributing to long term customer retention.

Because customer contracts under pay-per-use models are more complex and varied than straightforward subscription arrangements, you not only need more sophisticated monitoring tools, you also need to provide customers with a window into their usage behavior. These tools could take the form of tailored reports or dashboards

that chart historical and current usage patterns, as well as web portals that allow customers to purchase more capacity or add new features as their needs change.

As part of your compliance-monitoring responsibilities, you also need to determine whether any risks are being introduced by how customers are using your offering. For example, if under the new model, your customer is restricted from using the new service or offer in certain ways—such as integrating it with other technologies or systems—then you will need new capabilities and processes in order to validate compliance with these restrictions.

Other factors also come into play. For example, because the service may be hosted in your data centers, the location of those centers will affect what global regulations you need to comply with. You also have important compliance obligations with respect to the handling and securing of any personally identifiable information (PII) or protected health information (PHI) that is housed in your IT environment.



Major adjustments may be needed in how companies monitor customer compliance with the terms and conditions contracts, including giving customers the tools they need to monitor and adjust their service usage.

# Taxation: It's all about location

When it comes to taxation of flexible consumption offerings, one word takes precedence: location. The location of technology infrastructure and critical employees is increasingly determining taxation. The more processing and related services that take place in a particular location, the more tax nexus there is, making it challenging for companies to manage global tax compliance and [optimize their tax structure](#). In fact, based on the changes introduced by the Organization for Economic Co-operation and Development's Base Erosion and Profit Shifting project, taxpayers are having to reevaluate their global operations in order to determine if changes to transaction flows or operational substance are necessary to maintain or enhance their current tax profile.

It is important for your leadership to understand what elements of your organization's intellectual property (IP) drives

value – whether it is software, data sets, analytics, or algorithms—and to determine how much of that IP is IP in the classic sense, and how much of it is embodied in human capital. For instance, if a company is in the business of designing algorithms, it is the people who are the value drivers. Leaders can then design transactional flows to match their operations. That will help determine where the IP should be held—including where people should be located--in order to optimize taxation.

Ultimately, your tax professionals will need a firm grasp of the underlying technology and delivery mechanisms that create value so that they can provide substantive and effective recommendations for [optimizing the tax structure](#) around those operations and systems.



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# Let's talk

Companies [transitioning to flexible consumption models](#) often underestimate the degree to which they may need to strengthen—and even develop from scratch—their capabilities. From finding new ways to optimize their tax position to completely revamping incentives and compensation, the changes often reach into the core of the organization.

[Deloitte has guided numerous companies](#) through business model transformations towards flexible consumption, and we understand the complexity of the challenge, including the capability enhancements that will be required across the entire enterprise. Let's talk about what the change will mean for you.

In the meantime, be sure to check back for a [monthly dose](#) of the latest issues driving the future of TMT companies. Stay tuned for more in our Flashpoints series on flexible consumption and its impacts across the organization, from business strategy through technical enablement.

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