Relationships, Retention, and Revenue

The Connection Between Payments and Subscriptions

Payments Expertise Level:

BASIC	INTERMEDIATE	**ADVANCED**
The beginning stages of learning about recovering failed subscription payments	Digging a bit deeper into more advanced methods of handling your failed subscription payments	**For those who are ready to implement the most advanced tactics for revenue recovery now!**

FlexPay

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Payments Expertise Level:

ADVANCED

Introduction

Welcome to the **Advanced** content series for payments experts who want to take their payments tech stack and performance to the next level. While the thought leadership, guidance, and best practices presented in this series are open and applicable to all subscription companies, FlexPay's advanced-level content will be immediately useful to companies with a more developed understanding of payments, involuntary churn, and the applied usage of customer LTV. The intent of this series is to provide an advanced playbook to companies with higher levels of operational efficiency — companies that have optimized their payments tech stack for long-term relationships and are already realizing best-in-class management of involuntary churn.

In short, FlexPay's advanced-level content will help smart finance, payments and operation professionals further elevate the strong performance they are already delivering to their subscription businesses to the level seen by top performing companies.

The subscription business model is founded on the premise that creating ongoing, long-lasting relationships with customers creates a healthy business. The customer gets regular delivery of the product or service they desire, and the business gets predictable, ongoing revenue.

Smart subscription businesses recognize the value of increasing customer retention since it ensures an ongoing stream of money coming in. They understand that the health of the business increases when customer retention increases, so they invest significant resources to reduce customer churn. They build programs directed towards reducing customer cancellations, measure and maintain customer satisfaction, and work to save customers when a cancellation request is made by a customer. All these actions are based on the belief that customer churn is caused by customers cancelling their subscriptions.

But this is only part of the story. In reality, up to 48% of customer churn is caused by failed payments, otherwise known as involuntary churn. The good news is that many subscription businesses have started to recognize this, and have undertaken efforts to recover failed payments and reduce the churn they create.

However, there is a central problem with the way that many businesses view failed payments — they are perceived as a transactional problem. Meaning the payment authorization request is declined, and so attempts are made to recover the payment transaction.

The proper way to view failed payments and ways to solve them

There is a more effective way of viewing failed payments, and understanding this will make it clear how you should optimize your payment infrastructure to minimize — or even eliminate — the negative impact they have on your business. When a payment fails, it results in two possible outcomes: Either the customer is recovered, or the customer churns.

The ideal recovery solution starts by reframing the failed payments problem from:

"We want to reduce our rate of failed payments by recovering as many of these transactions as we can"

to:

"We recognize the direct connection between payments and relationships, so we work to optimize the recovery of customers from failed payments, and maximize the retention of customers following their recovery."

This approach aligns most closely with the subscription business model — acquiring and retaining customers for as long as possible to maximize revenue, retention, and LTV. This means subscription companies optimize the failed payment problem by applying and optimizing the 3 Rs of the subscription business model: Relationships, Retention, and Revenue.

WHEN A PAYMENT FAILS, THE OUTCOME IS EITHER A CUSTOMER WHO IS RETAINED WITH A LONG-LASTING RELATIONSHIP FOLLOWING RECOVERY, OR A CHURNED CUSTOMER.

First-generation failed payment recovery and why it comes up short

Many subscription companies have recognized the connection between failed payments and involuntary churn and have taken efforts to solve the problem. We applaud these companies for taking the first step, but unfortunately many of these companies apply what we call a first-generation solution.

A first-generation solution views failed payments as a transactional problem and works to solve them with a lowest-cost approach. The typical first-generation approach is to build an in-house retry system that applies rules to retry failed payments on some regular schedule. The other common first-generation solution is to send customers with a failed payment to customer service for outreach, or even worse, collections.

The goal of these approaches is to minimize the cost of recovery, with the misguided belief that any recovery earned is great and minimizing the cost of recovery is even better. This shows a lack of understanding of the problem because the supposed best outcome in these first-generation solutions is based upon two common misinterpretations:

1. **Not understanding that the success of the program should be measured and optimized to increase relationships, retention, and revenue, and not on the cost to deliver this program.**

2. **Not assigning an opportunity cost to internal efforts.**

What companies should do instead

The success of your company's failed payment recovery program should be measured in two ways:

1. **The total revenue recovered, net of recovery costs.**

2. **The total revenue/LTV generated by recovered customers over the remainder of their active lifetime.**

Companies must recognize that all internal recovery programs create direct and indirect costs. Here are the two most common types of first-generation home-built solutions, and the costs they incur for a business:

1. **Rules-based retry systems:** While maintenance costs for these systems may be low, they aren't zero. The biggest cost created by rules-based retry systems is the dollar value of all the failed payments that these systems can't recover compared to the results of specialized systems with better performance.

   In addition, retry systems generate large volumes of retry attempts, which contribute to a higher risk score for your merchant account. This creates a vicious cycle of higher failed payment rates, which further exacerbates the problem.

2. **Customer service outreach and/or collections:** Both are high-cost activities. While it may seem logical to use an existing in-house service team to engage with customers who experience a failed payment problem, this unfortunately entails using your highest-cost resource (labor) to achieve results that underperform compared to specialized solutions and contributes to churn. Another vicious cycle.

How to compare internal programs against a specialized failed payment recovery solution

Companies should compare the loaded revenue and costs of internal programs against the cost of specialized third-party solutions.

The simplest way to measure internal and specialized recovery solutions is to measure the amount of net revenue in the month of the failed payment recovery. The calculations to measure single-month net revenue looks like this:

Internal failed payment recovery rate = Recovered transaction quantity / Failed payment transaction quantity

and

Specialized failed payment recovery rate = Recovered transaction quantity / Failed payment transaction quantity

The typical period of measurement is a calendar month, where the failed payment recovery quantity is measured in the 30 days after the month-end containing the quantity of failed payments.

Comparing the results of these two calculations provides an easy way to measure the lift in recovery provided by the specialized recovery solution.

How to do simple net revenue comparisons

Net revenue earned from **internal** solution = (Recovered transaction quantity X Order value) – Recovery costs

and

Net revenue earned from **specialized** solution = (Recovered transaction quantity X Order value) – Recovery costs

Comparing the results of these two calculations provides an easy way to measure the incremental revenue a specialized solution provides while also accounting for the direct costs of the third-party solution.

How to do full net revenue comparisons

Full LTV earned from customers recovered by **internal** solution =

(Recovered transaction quantity X Order value X Recovered billing cycles) – Recovery costs

and

Full LTV earned from customers recovered by **specialized** solution =

(Recovered transaction quantity X Order value X Recovered billing cycles) – Recovery costs

Measuring the full revenue contribution of customers recovered from failed payments is critical if you want to maximize your chances for success. The results of these calculations make it clear that using a recovery solution that provides the highest recovery rate is always preferable — the cost of recovery is small compared to the full amount of revenue gained over a customer's lifespan following recovery.

FlexPay in action

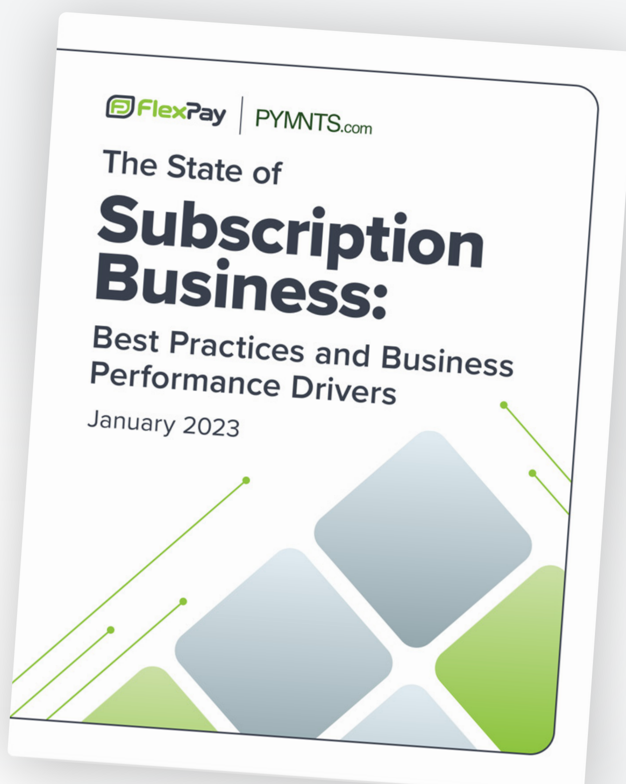
FlexPay recently conducted an analysis of a representative sample of their customers, comparing revenue earned by using FlexPay to the revenue earned by internal retry systems.

The results were clear. Even when measuring the amount of revenue earned during just a single month of recovery, these users earned more revenue because of the higher recovery rates FlexPay delivered, net of recovery fees.

FlexPay delivered an increase of 47% in recovered customers, and an increase in single-month revenue after taking into account the 15% recovery fees. Measuring the full LTV of the additional customers recovered increases this revenue gain to closer to 55%.

Best practices from this study

A recent industry benchmark study conducted in partnership with PYMNTS found that top performing subscription companies use specialised third-party solutions, with the foremost companies using an average of 2.6 recovery methods.



The power of recovering fresh declines

These foremost top companies apply the highest performing recovery solution first, and then use additional methods, such as customer outreach, afterward. These companies get these great results by using a specialized solution on fresh declines as soon as the payment request fails. By doing so, these solutions will deliver the highest recovery rates. However, the probability of recovery decreases with each recovery attempt and each day that passes after the initial decline. Excessive recovery attempts also harm merchant account health, so recovering fresh declines quickly is ideal.

Summary

Successful subscription businesses build long-lasting customer relationships to increase their retention and revenue. To do this, they optimize their customer LTV by reducing the number of failed payments that contribute to churn. Optimizing LTV with an effective third-party recovery solution instead of focusing on the short-term revenue gained by traditional customer outreach activities is necessary to get the best results.

Focusing on short-term costs will lead you to think that reducing this expense is the correct direction to take, but this is the wrong metric to optimize because it misses the opportunities you will gain by improving customer retention and LTV growth.

The most successful companies include this focus on LTV in their failed payment recovery best practices. To become one of these top performers, you should measure the success of your recovery efforts through the lens of improved LTV and the ROI it provides.

FlexPay is the leading Payment Authorization Management solution, helping subscription businesses accelerate revenue and profit growth by recovering failed payments, which is the single largest cause of customer churn.

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