Top 5 SaaS Finance Terms

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Bookings, Billings, ACV and TCV

All these terms are linked to each other. But we should know that these should not be used interchangeably. The differences between them are so lean that even experienced executives can get confused. As a B2B SaaS Finance executive, you should be aware of the differences between these terms and understand them very clearly.

Let's understand these terms with the help of examples –

A. Bookings – Bookings mean the situation when a customer commits to spend money on your product or service. This step can be understood as the signing up of a contract between the customer and the company.

Example - Customer "A" signs up a contract for a two-year paid plan offered by your company worth $12000 - this event will be considered booking for your company.

B. Billings - Billing is the next stage after booking in a SaaS business. Billing is the event of collecting money from your customers who have booked your product or service. This stage can be further understood as raising the final invoice to the customer against the signed contract.

Example – Your company raises an invoice worth $12000 to the customer "A" as agreed in the contract. This event will be considered Billing for your company.

C . TCV (Total Contract Value) and ACV (Annual Contract Value) - The TCV means the total value of the subscription contract measured over the life of the contract regardless of the Billings terms whereas ACV means the annual value of TCV based on the contract period. Hence the 2-year contract has a TCV that is twice the amount of its ACV.
In our example – ACV is $6000 whereas TCV is $12000 (i.e.,2x of ACV)

Annual Recurring Revenue (ARR) and Monthly Recurring Revenue (MRR)

A. MRR - Monthly recurring revenue (MRR) is the sum of recurring revenue a business recognizes in a given month.

The basic formula for MRR is pretty simple: for any given month (period t), simply sum up the recurring revenue generated by that month's customers to arrive at your MRR figure.

B. ARR - ARR measures the recurring revenue you'd generate over the course of a year. For forecasting purposes, ARR is used to predict annual recurring revenue for the coming 12 months, assuming no changes to your customer base.

The formula for ARR is pretty straight forward: **ARR = MRR * 12**

Example 1 – The company sold a monthly subscription cost of $200 to 2 customers in January. In February, the company gain another customer, and MRR increases as a result as follows:

Jan 2023 – **MRR = $400 ($200+$200) and ARR = $4800 ($400*12)**
Feb 2023 – **MRR = $600 ($200+$200+$200) ARR = $7200 ($600*12)**

Example 2 - The company sold a monthly subscription cost of $200 to 2 customers in Jan 2023 & in Feb 2023 the company sold another Monthly subscription and one annual subscription of $12000. MRR increases as a result as follows:

Jan 2023 – **MRR = $400 ($200+$200) and ARR = $4800 ($400*12)**
Feb 2023 – **MRR = $1600 [$200+$200+$200+$1000($12000/12)] and ARR = $19200 ($400*12)**

Importance of ARR & MRR – ARR & MRR is a vital SaaS business term that signifies how much recurring income you can expect yearly & monthly basis. In simple terms, ARR shows how your company grows on a yearly basis whereas MRR shows you how your company grows on a monthly basis. This gives an in-depth overview of your business health and the rate you need to grow to get the desired success.

Average Revenue Per User (ARPU)

ARPU is Average Revenue Per User. It is the amount of money a single customer generates for a SaaS company. It is a vital SaaS financial metric because it let you find the best ways to cross-sell and upsell prevailing customers.

ARPU = Monthly Recurring Revenue (MRR) / No of customers generating that MRR

Life Time Value (LTV)

Lifetime value (LTV), or Customer Lifetime Value (CLV), is the total amount of money a customer spends on your SaaS product or service during the customer's entire relationship with your business.

If the customer spends $500 a month on your SaaS product and stays with your business for a period of 12 months before moving on to another product, the customer's lifetime value would be $500 * 12 = $6,000

Importance of LTV - SaaS LTV tells you what the entire customer relationship is worth to your business. The longer a customer stays with your business, the higher the LTV and, therefore, the higher the worth of that relationship to your business. A high LTV contributes to a SaaS company's profitability since it's nearly impossible to recover the investment SaaS companies make in acquiring new customers simply from a one-time purchase by the customer. By calculating SaaS LTV, you'll be able to figure out which customer relationships have the highest LTV and you should focus on retaining.

There are a few different ways of calculating LTV for SaaS businesses:

Method 1 – LTV = Average Revenue Per User / Churn Rate*

**Churn rate is the number of subscribers who cancelled their subscription during a specific period of time. For example, if you had 200 subscribers in the previous year and lost 10, the churn rate is 5%. The higher the customer churn rate is, the lower the lifetime value will be. If the average revenue per customer is $50, and the churn rate is 5%, then the LTV is $50 / 0.05 = $1,000.*

Method 2 - LTV = (Average Revenue Per user * Gross Margin %) / Revenue Churn Rate.

The variables in this equation are:

1. **Average revenue per user** = MRR (Monthly Recurring Revenue) / Total Number of Accounts
2. **Revenue Churn Rate** = Revenue Lost in a Specific Period / Revenue at the Beginning of the Period.

*This formula helps you see the LTV in gross profit terms, not in revenue terms. If the average revenue per customer is $50, the gross margin is 10%, and the revenue churn rate is 5%, the LTV would be ($50 * 0.10) / 0.05 = $100.*

CAC (Customer Acquisition Cost)/CPA (Cost Per Acquisition)

Marketing at the wrong platforms can ruin the profit margins quickly. The only way to prevent this to track Cost Per Acquisition (CAC). It means this important SaaS term will let you understand if you have a positive ROI or not. This will give you the total expenses you spent on every newbie customer

CAC = Total Sales & Marketing expenditure / New customers added

LTV/CAC Ratio - If you are spending more money to get customers than you get, you have a big problem. Remember, if your Customer Lifetime Value (LTV) is more than CAC, you are in the right direction.

The LTV to CAC ratio, as a benchmark, should be at least 3:1. If it isn't above 3, you're spending way too much on customer acquisition, or you're unable to retain your customers over time. On the other hand, if your ratio is too high, like above 5:1, it is likely you are under-spending on marketing and limiting growth.

Thank you