How Do You Calculate Business Service Revenue?

6 min read

Service revenue does not necessarily indicate profits because it's an above-the-line item and profits depend on below-the-line expenses.

Key Takeaways

- **What Is Service Revenue?:** Compared to total revenue, which includes revenue from all revenue streams including product sales, interest income, rents, or other revenue sources, service revenue is solely comprised of the…

- **Using Service Revenue to Evaluate Financial Health:** Service revenue, when evaluated alongside other financial data, can provide business owners with invaluable insights into the financial health of their businesses. When assessing your service revenue…

- **Streamline Your Back Office for Better Financial Insights:** To better tackle the challenges of calculating service revenue, optimizing your pricing for better margins, and keeping track of it all so that you'll have accurate...

However, service revenue is still an essential metric to calculate and track in your company because it can help you take the temperature of your financial health, measure performance, distinguish between and evaluate different revenue streams, and leverage a variety of forecasting models.

What Is Service Revenue?

Service revenue is a category included in a company's sales revenue and total revenue that contains only revenue from the sale of services provided. Compared to total revenue, which includes revenue from all revenue streams including product sales, interest income, rents, or other revenue sources, service revenue is solely comprised of the sales of services that a business has rendered to its customers.

Service revenue contains service sales that have been billed and earned. In an accrual basis accounting system, this revenue is recorded whether or not the payments have been collected.

Service revenue can be included as a separate line item near the top of an income statement. This is usually advisable if it makes up a significant portion of a company's total revenue. When service revenue is insignificant, it usually will not have its own line on the income statement, and any minimal revenue coming from services would simply be included with that company's product revenue.

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How to Calculate Service Revenue

Service Revenue Formula

In a service business, you use the service revenue formula:

- Service Revenue = Number of Customers x Average Price of Services

It should be noted here, as well, that in a product-based company or a service company that also sells products, you would use the sales revenue formula to calculate the revenue from product sales:

- Sales Revenue = Number of Products Sold x Average Price of Products

Using Service Revenue to Evaluate Financial Health

Service revenue, when evaluated alongside other financial data, can provide business owners with invaluable insights into the financial health of their businesses. When assessing your service revenue, consider the following:

- How does your current service revenue compare to previous financial periods? Is service revenue increasing or decreasing?
- Is your current service revenue figure greater or smaller than what you predicted and budgeted for?
- How much of your services revenue are you holding onto in your net profit? Or what kind of profit margins are you generating on your service sales?
- Is your profit margin increasing, decreasing, or remaining stable? What has caused the change, if any?

Common Challenges of Calculating Service Revenue

In addition to learning how to calculate and use your business's service revenue figures, you should also be aware of some of the most common pitfalls encountered when dealing with service revenue calculations and evaluations.

Handling Deferred Revenue

Whether you operate with a cash basis or accrual basis accounting system, you can only count revenue from sales toward your revenue when it has been earned. This can present some complications to service businesses that operate with subscription pricing models where customers often pay before services have been delivered.

For example, a business might offer an annual subscription plan that provides monthly services to its customers. Customers pay a single fee at the beginning of the year that should be added to the company's liabilities. The business can then transfer 1/12 of that fee into its revenue after each month it delivers services.

When this is the case, a business needs to develop a system for managing subscription fees and rolling them from their liabilities to their revenue once services have been delivered and the revenue has been earned.

Read More: [3 Steps To Fix The Pricing Problems In Your Service Business]

Manually Recording Revenue

Manual processes anywhere in bookkeeping and accounting present challenges and opportunities for errors to occur. When it comes to recording revenue, attempting to do so manually is not recommended because it poses several challenges. These include keeping track of individual payments, customer accounts, and subscription or fee models in addition to tracking the methods for how the fee for each service is earned, charged, paid, and rolled over from liability to revenue.

"We were **profitable the first month** and I knew it because my accounts and books were clean and I could understand where the money was coming from and going to."

- **Joe Aikens, CEO of JTAM Engineering**

Read the full story on how this service business reached profitability with the help of management reporting.

Tracking Changes That Affect Revenue

In addition to manually recording revenue, keeping track of changes that occur in your revenue models can present challenges to calculating service revenue. For example, if you make changes to your prices, subscription models, or fees during the financial year, you need to account for these changes in your service revenue formula because the average prices could change too drastically to achieve an accurate service revenue calculation based on a single average.

Cash Flow vs. Service Revenue

If you're operating with an accrual accounting system, then you need to look at a cash flow statement in addition to your service revenue to truly understand the financial health of your company. Your service revenue could be in great shape, but it doesn't represent actual cash in your company.

If, for example, your customers aren't paying you on time or are waiting through the entire repayment period to make their payments, then your days sales outstanding numbers could put you in a cash flow pickle.

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Be careful not to focus only on your service revenue, but also on the cash that's actually flowing in and out of your company to ensure you'll be able to pay your bills because sometimes bills can be difficult to pay even when service revenue is strong.

Streamline Your Back Office for Better Financial Insights

To better tackle the challenges of calculating service revenue, optimizing your pricing for better margins, and keeping track of it all so that you'll have accurate financial statements to help you run your business properly, you're going to need a back office that's fully equipped to support these complex bookkeeping and accounting challenges.

With a back office equipped to automate manual bookkeeping and accounting processes in service-based businesses, you can better track your subscription fee-based liabilities, earned income, and collected payments to ensure your service revenue calculations are always timely and accurate.